

TLC THE LASER CENTER INC.



1998 Annual Report

Strategy for **Growth**

Corporate

Profile

TLC The Laser Center Inc. is the world's largest provider of laser vision correction services. TLC's core business is providing excimer laser eye surgery in partnership with its network of more than 7,000 affiliated doctors. To support its core refractive business, TLC also operates strategic ancillary businesses and support programs. These include secondary care facilities, managed care programs, buying groups and information technology systems.

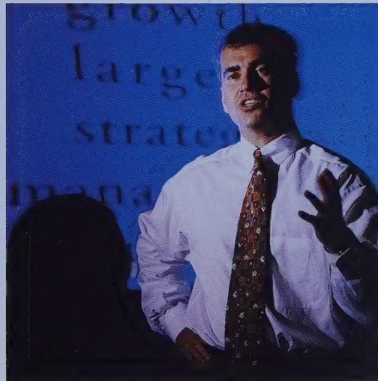


TLC is now reporting in U.S. dollars The majority of TLC doctors, centers, employees, and shareholders are now in the U.S. The U.S. dollar, therefore, has been adopted as TLC's reporting currency effective May 31, 1998 and is used throughout this annual report.

In this year's annual report we have focused on **key areas** that highlight our past performance and indicate the Company's prospects for continued success.

TLC performs the **largest number of procedures**,
has **the most facilities**,
and records the **largest revenues** of all our peers.

Our Investment **Characteristics**



- We have **expanded rapidly** in the U.S. and Canada
- We have built a **geographic diversity** that is unique in our industry
- We have seen **dramatic same-store procedure growth** in our clinics
- We have a **strong established network** of well-trained and experienced doctors
- We have an extraordinary "Lifetime Commitment" to our patients and are **a clinical leader**
- We have been the **most successful consolidator** within the industry
- We are taking advantage of exceptional **growth in the market** for laser vision correction
- We have a **proven management team** that continues to drive our growth

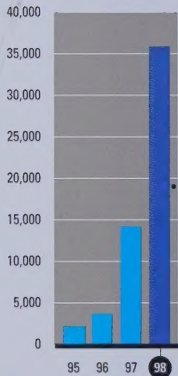
Financial Profile

Our industry is growing very quickly. So fast, in fact, that we've always said

TLC must grow by **100%** each year just to maintain its position

as the market leader. We have done **better** than that.

**TOTAL
PROCEDURES**
by year

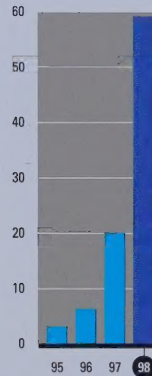


indicator

152%
increase
from 1997

Strong growth in procedures resulted from very robust same-store growth in our existing centers and from adding new centers.

**NET
REVENUES**
US\$ millions

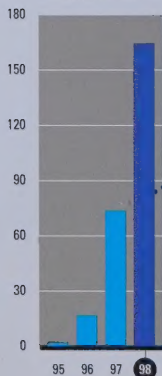


indicator

194%
increase
from 1997

Revenues have grown substantially due to an increase in procedures performed and the effect of acquisitions.

**TOTAL
ASSETS**
US\$ millions

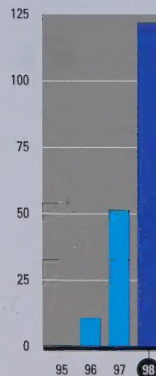


indicator

123%
increase
from 1997

Rapid expansion has meant that assets have grown considerably, providing the Company with the resources to continue building on its already dominant market position.

**SHAREHOLDERS'
EQUITY**
US\$ millions



indicator

137%
higher
than in 1997

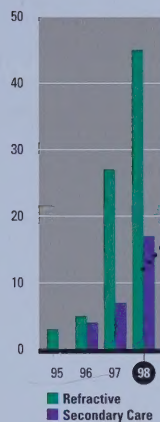
Rapid expansion has also meant a dramatic increase in shareholders' equity.

In last year's annual report, TLC committed to growing its cash flow and managing its existing business.

With that in mind, the Company outlined a plan to open fewer centers in 1998 than in 1997.

As it turned out, the opportunities for expansion were too great, and TLC was able to absorb much more of the resulting operating losses than expected.

TOTAL EYE CARE CENTERS OPENED OR ACQUIRED

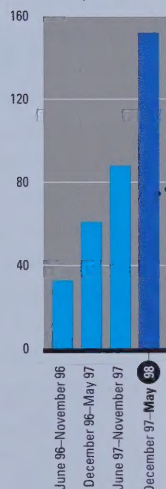


indicator

18 refractive and 10 secondary care centers added; quicker expansion than forecast

The Company's takeover of BeaconEye Inc., and other smaller acquisitions completed in 1998, reinforced TLC's position as the only significant consolidator within its industry.

AVERAGE SAME-STORE PROCEDURES
by month

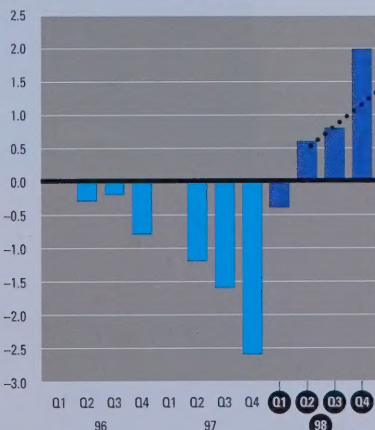


indicator

149% increase in same-store procedures over 1997

An analysis of the first 14 centers opened in Q1-97 upon FDA approval shows that growth in same-store average procedure volumes has kept pace with growth achieved through new center openings and acquisitions.

EBITDA BY QUARTER
US\$ millions



indicator

First-time positive EBITDA; much sooner than expected

Earnings before interest, taxes, depreciation and amortization (EBITDA) trended upwards throughout 1998. As more TLC centers matured following the Company's initial expansion into the U.S. much of the negative impact from opening and acquiring new centers has been successfully offset.

Where We Are Today

45 refractive centers and
17 secondary care centers
operating in 25 states
and provinces across
North America



● TLC Refractive Center
● TLC Secondary Care Center

TLC REFRACTIVE CENTERS

Ada, OH
Arlington, TX
Atlanta, GA
Austin, TX
Billings, MT
Boca Raton, FL
Brea, CA
Charlotte, NC
Cleveland, OH
Denver, CO**
Detroit, MI
Elmwood Park, NJ

Fairfax, VA
Fort Lauderdale, FL
Garden City, NY
Greenville, SC
Houston, TX
Indianapolis, IN
Irvine, CA
Johnson City, TN
Lansing, MI*
London, ON
Lynnwood, WA
Madison, WI*

Moncton, NB
Mount Laurel, NJ
New York, NY
Oklahoma City, OK
Pittsburgh, PA
Plymouth Meeting, PA
Raleigh, NC
Richmond Hill, ON
Rockville, MD
San Antonio, TX
Sicuate, MA
Tampa, FL

Toronto, ON**
Tulsa, OK
Vancouver, BC
Westchester, IL*
White Plains, NY
Windsor, ON
Winston-Salem, NC

* Center also provides
secondary care
** Denotes two
refractive centers

TLC SECONDARY CARE CENTERS

Auburn, WA
Battle Creek, MI
Burlington, WA
Chelsea, MI
Eik City, OK
Jackson, MI
Lansing, MI
Madison, WI
Mount Vernon, WA
Oklahoma City, OK

Palos Heights, IL
Seattle, WA
Sequim, WA***
Smokey Point, WA
Westchester, IL
Ypsilanti, MI

*** Denotes two secondary
care centers

TLC Operational Facts

At TLC, we have successfully distinguished ourselves from our competitors.

We are committed to providing the highest possible level of care and the best clinical results to our patients in partnership with our network of well-trained and experienced doctors.

A TLC center involves much more than just scheduling laser procedures.

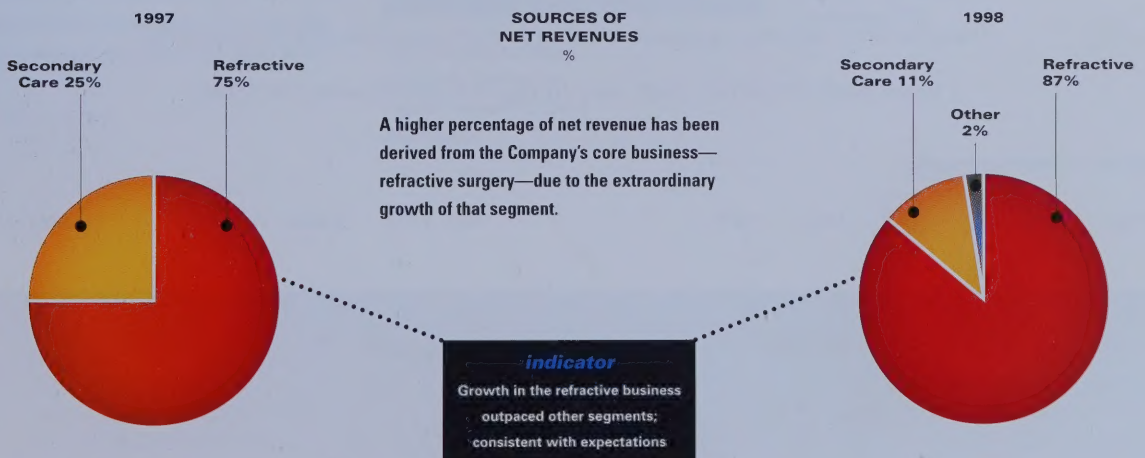
It is a patient focused, market driven, high quality outpatient refractive surgery center.

- A typical TLC refractive center has between 4,000 and 5,000 square feet of space and is usually located in an office building. Each center is equipped with at least one excimer laser (a few of the busiest ones have two).
- Every TLC center has a director, who is an optometrist and oversees the clinical aspects of the center and builds and supports the center's co-management network. Most TLC centers also have a professional relations coordinator who works closely with the center director to support the doctor network and their staff to further market TLC's services.

- Each center has a business manager, a receptionist, ophthalmic technicians and patient consultants. An executive director prepares the center's annual strategic plan and manages day-to-day activities.
- Medical directors perform the vast majority of laser procedures at a TLC center. Medical directors generally sign agreements that include non-competition clauses as they perform all of their procedures exclusively at TLC facilities.
- When it comes to their eyes, the majority of people want to deal only with the most experienced care provider. TLC's focus is on providing the highest level of care and the best

clinical outcomes. TLC has positioned itself in the high end of the market with the highest quality equipment and well-trained doctors. Only TLC has the information technology and the outcome analysis programs that allow the ongoing monitoring and analysis of its results and the performance of its doctors.

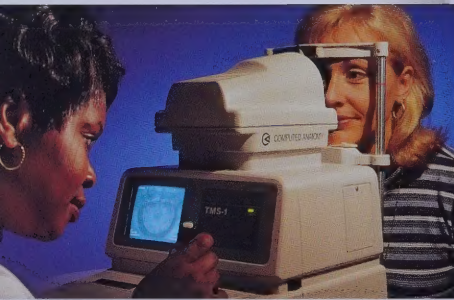
- TLC is not a laser company. We are dedicated to reducing people's dependence on glasses and contact lenses. New procedures and technology advances will be incorporated into TLC centers as the need evolves. In fact, TLC doctors have pioneered many of the refractive surgery techniques considered state-of-the-art today.



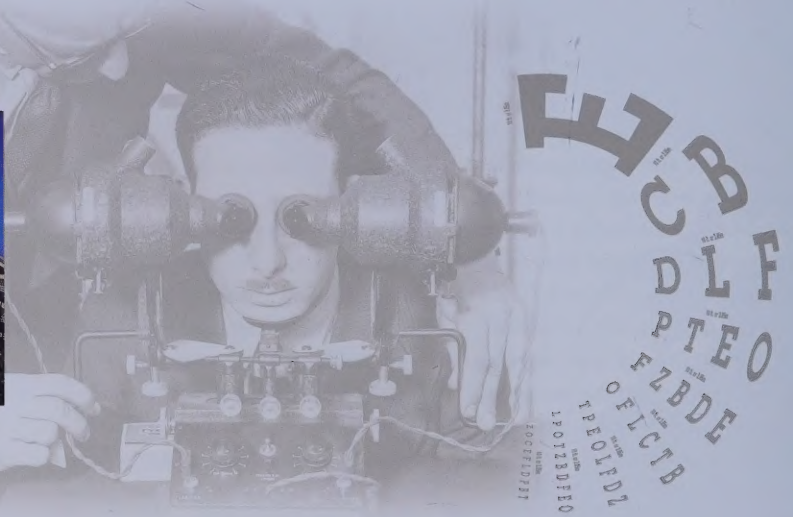
TLC's years of Expertise

Surgery to reduce people's dependence on glasses and contact lenses isn't new.

In fact, it's been done for more than 20 years.



TLC ophthalmic technician, Jenny Graham, uses a corneal topographer to determine the exact shape of patient Beth Hahn's eyes.



The first procedure used to alter the shape of the cornea and correct vision was called Radial Keratotomy (RK). To perform RK, a surgeon would use a hand-held diamond-tipped scalpel to make multiple incisions that penetrated about 90% of the cornea.

Despite this, industry sources estimate that over 200,000 procedures were performed just that way in the U.S. as recently as 1994.

Industry Background

1970s

1976

1980s

FIRST TREATMENT

Doctors begin treating myopia with the RK procedure. Over 1 million people worldwide have RK over the next 20 years.

GROUNDWORK LAID

IBM develops excimer laser technology to etch microchips.

NEW APPLICATIONS

It's discovered that the excimer laser can remove corneal tissue. Each pulse of the laser can remove 0.25 microns of tissue in 12 billionths of a second, without affecting the area outside of the target zone. In 1985, the first experiments are performed on human eyes.

**So what has everyone
so excited? It's the
phenomenal accuracy
of the excimer laser.**

It was invented by IBM in the late 1970s to etch microchips. The excimer laser is so accurate that each pulse removes just 39 millionths of an inch of tissue in 12 billionths of a second.

Laser vision correction is a simple but highly sophisticated five to ten minute outpatient procedure that uses an excimer laser guided by a sophisticated computer to reshape the curvature of the cornea (the surface layer of the eye). The procedure is performed for the correction of myopia (near-sightedness), hyperopia (farsightedness) and astigmatism. The procedure itself is painless, and patients are typically back at work in one to three days.

TLC has pioneered many of the techniques used today in the laser vision correction industry. Indeed, TLC doctors were the first to perform LASIK (see inset) in both Canada and the U.S. Now, LASIK accounts for more than 80% of all refractive procedures performed at TLC Centers throughout North America.

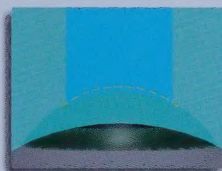
Regulatory approvals for laser vision correction technologies have come more quickly in Canada, providing the Company with distinct clinical and competitive advantages. For example, the treatment of hyperopia has been

commercially available in TLC's Canadian centers for more than a year now, providing our surgeons with extremely valuable experience performing this procedure. The treatment of hyperopia has yet to be approved in the U.S.—but we hope that will come sometime this year. Seven TLC centers have been chosen to take part in the clinical trials for hyperopia and we are already upgrading all the lasers in our U.S. centers to be "hyperopia ready."

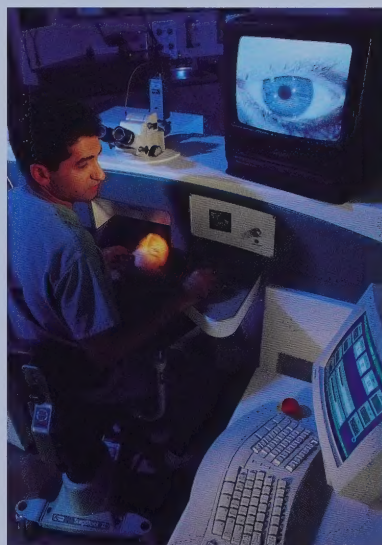
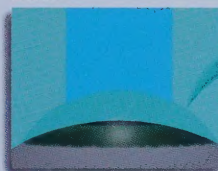


A single strand of human hair etched with the excimer laser, demonstrating exceptional precision.

PRK



LASIK



Beth Hahn has her vision corrected under the very capable care of TLC doctor Omar Hakim.

Two laser vision correction procedures are performed at TLC—PRK and LASIK. The same cool laser beam is used to gently reshape the cornea to match a person's prescription during both procedures. However, with LASIK the doctor first creates a protective flap using an automated instrument called a microkeratome. LASIK dramatically reduces a patient's recovery time (versus PRK). In fact, LASIK has become so popular that it now accounts for more than 80% of the procedures performed at TLC.

1991-1996

1996-1997

1998

CANADIAN EXPERIENCE

Dr. Jeffery Machat is one of the first doctors in Canada to perform laser vision correction. Dr. Machat co-founds TLC with Elias Vamvakas in 1993. The first TLC center opens in Windsor, Ontario and it quickly becomes one of the most successful laser clinics in the world.

U.S. INTRODUCTION

FDA approves laser for PRK to treat myopia. TLC begins its rapid expansion into the U.S. using the newly approved equipment. By now, Dr. Machat has personally performed over 10,000 procedures. The treatment of hyperopia becomes commercially available in TLC's Canadian centers.

MARKET EXPANDED

The majority of procedures performed in the U.S. and Canada are now LASIK. Seven TLC centers are chosen to take part in hyperopia studies in the U.S. TLC begins the simple process of upgrading all U.S. centers to be "hyperopia ready."

Message to Shareholders

TLC's success comes from our **strategy, our focus,**
and our unique **partnerships with doctors.**

DURING THE PAST YEAR WE NOT ONLY MAINTAINED, WE

No other company in
the world came close
to the number of
refractive procedures
that were performed
in TLC clinics in 1998.

What a great year 1998 was for us. When we opened our first center more than four years ago, we decided that TLC would not be a company focused on offering doctors shared access to the expensive excimer laser. We believed that the laser was a revolutionary (and very expensive) piece of equipment, but still, just a tool. We saw our core competence as TLC's ability to bring patients together with well-trained and experienced doctors, rather than just being able to manage facilities that house lasers.

with the greatest doctors in eye care; doctors whose skills and reputations are world renowned. Such leaders create the synergy that drives our growth and that continues to attract other doctors and patients—building the strength of the organization and everyone associated with it.

Acquisition of BeaconEye Inc.

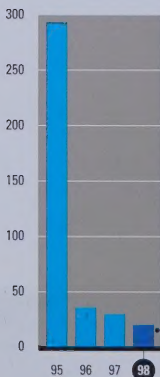
The takeover of BeaconEye Inc. in April was a key development, adding 11 clinics to our network. Like TLC, BeaconEye relies on a strong network of local doctors. Barry Critchley, a columnist for *The Financial Post*, observed that TLC's acquisition of BeaconEye "...would seem to be a classic example of Economics 101." I'm not going to disagree with him. We have moved swiftly to mitigate the negative earnings and EBITDA impact of the BeaconEye centers. Both of BeaconEye's corporate offices, one in Texas, the other in Ontario, have been closed and the integration of operations and staff of the two companies is going very well.

Co-management—

A Unique Model That's Working

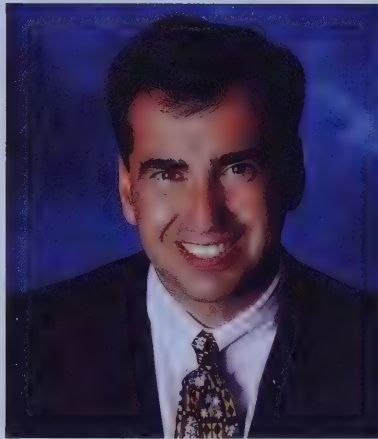
We've always realized the importance of focusing our strategy on the doctor-patient relationship. Our emphasis on putting patient care first has had an incredible effect on both the clinical results that our patients have experienced, and in the very large numbers of referrals from patients that have resulted. This has provided a solid foundation for the growth of our business. The strategy has allowed us to affiliate

**DEBT TO
EQUITY
%**



Growth in procedures, revenues, and assets has been carefully managed, further reducing financial risk.

indicator
Ratio
continued
to improve



GREW OUR LEADERSHIP POSITION IN THIS INDUSTRY

Financially Stronger Than Ever

TLC has been able to manage the BeaconEye and other smaller acquisitions, and absorb the operating losses associated with continued rapid expansion, while building on its very strong financial position. At May 31, 1998, our cash and short-term deposits had more than quadrupled to US\$56.1 million. Total short- and long-term debt was US\$24.7 million, comprised mostly of leases for our medical equipment. TLC's debt/equity ratio was 0.20:1 (20%); our quick ratio 4.2:1; and working capital stood at US\$54.0 million. The Company successfully raised US\$64.6 million in a public offering this year, leaving us in a strong position to continue growing our market share in this exciting industry.

Results That Exceeded Expectations

TLC's gross revenues in fiscal 1998 were a record US\$90.6 million, which is 276% of last year's total. The Company's net revenues almost tripled to US\$59.1 million in fiscal 1998. TLC generated positive earnings before interest, taxes, depreciation and

amortization (EBITDA) of US\$3 million for fiscal 1998, compared to negative EBITDA of US\$5.1 million for the previous year. This reflects a positive swing of US\$8.1 million over a twelve-month period. Achieving positive EBITDA was an important milestone for the Company, and was accomplished much sooner than expected. We were particularly pleased that this good performance continued in the fourth quarter despite the negative earnings and EBITDA impact of the BeaconEye acquisition.

Looking Ahead

In fiscal 1999, our goal is to achieve profitability. We plan to expand our leadership position in the laser vision correction industry and are committed to managing our expenses as we grow. In this regard, we have developed a four-part "Strategy for Growth" that is outlined in the next few pages.

As you can see, we are all very excited about our future. TLC is the No. 1 company in an industry that is growing extremely quickly. We've just

scratched the surface of this market's full potential. This presents us with tremendous opportunities and we have a strong management team that will help us take advantage of them.

TLC will continue to focus on what has made us so successful:

1. Treating patients with the highest level of care
2. Partnering with well-trained and experienced doctors
3. Providing a solid return for our shareholders
4. Attracting staff who are committed to our core values and have a passion for our business
5. Making certain that all of our partners prosper in their association with us

We look forward to yet another exciting year.

Elias Vamvakas

PRESIDENT AND CHIEF EXECUTIVE OFFICER
JULY 15, 1998



Strategy for
Growth

1

TLC clinics work
hand in hand
with local
doctors in
educating
patients about
the procedure
and in managing
post-procedure
care.

PARTNERSHIP WITH LOCAL EYE DOCTORS IS KNOWN AS CO-MANAGEMENT

Emphasizing TLC's **Co-management** Model

We have established a growing network of more than 7,000 affiliated doctors. To put this in perspective—that's more than **20% (1 in 5)** of all optometrists in the U.S.

People are very protective of their eyes—they won't let just anybody touch them. TLC's primary competitive advantage is our ability to bring patients together with well-trained, experienced doctors to advance the market acceptance of laser vision correction and deliver quality care.

Partnering With Local Doctors

Our successful business model—called co-management—is founded on the premise that two groups have the most influence on whether or not a candidate will decide to undergo laser vision correction and, together, they can provide the highest level of care and the best clinical results. They are primary care doctors (usually optometrists), who refer and co-manage patients, and refractive surgeons (ophthalmologists), who perform the procedures. Under the co-management model, TLC acts in partnership with both.

The Care

The laser vision correction procedure is performed at a TLC center by a very skilled and experienced refractive

surgeon. While the procedure itself has demonstrated tremendous clinical outcomes, the final results are strongly influenced by the delivery of proper pre- and post-operative care by a highly trained co-managing doctor. The selection of the right candidate and the appropriate management of expectations are crucial to producing a satisfied patient. After the procedure has been performed, regular follow-up and care is required. While complications are few, most of them occur during the post-operative healing period and it is important to identify and treat them in a timely manner.

Building Relationships

Each TLC center has an optometrist on staff who provides a wide range of clinical training and support services to affiliated primary care doctors. The goal is to support these doctors' individual practices and to assist them in providing quality patient care. The staff optometrist also goes out into the community to expand TLC's doctor network.

In many cases, however, local primary care providers know about the

TLC surgeons' clinical expertise long before our staff optometrist pays them a visit. In fact, they learned about us when they were still in school. That's because TLC provides educational programs in conjunction with seven of the top colleges of optometry in North America.

We also provide doctors with posters, videos, and brochures that help them to educate their patients about the procedure. In fact, the majority of TLC's marketing materials are designed and produced for use by our affiliated doctors.

The Economics

The primary care doctors who are affiliated with TLC charge fees to assess candidates for laser vision correction and to provide pre- and post-operative care to our patients. The care involved is extensive and includes both an initial eye exam and a minimum of six follow-up visits. The primary care doctor's potential revenue loss from the sale of contacts or eyeglasses is offset by these co-management fees. We are helping to build practices—not pull patients away. The model also generates key efficiencies for TLC; freeing up our center staff and resources to concentrate on what we do best—provide the highest laser vision correction services available.

"Lifetime Commitment" Program

TLC's revolutionary "Lifetime Commitment" program, established last year, entitles our patients within a certain range of correction to have additional procedures at no cost at any time during their lifetime should they need further correction. To remain eligible for

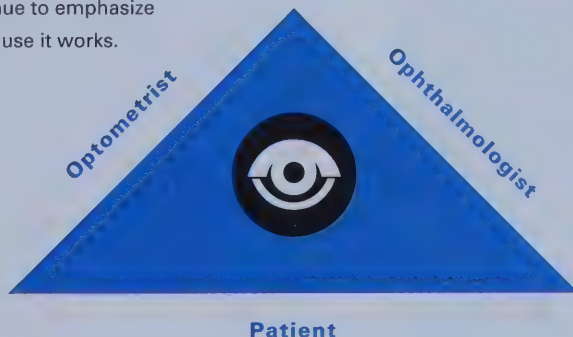


At the core of TLC are its refractive centers and the network of more than 7,000 affiliated doctors who co-manage patients.

the program, patients must continue to have annual eye exams with a TLC affiliated doctor, for which they pay the doctor directly. This powerful program has been very well received by patients and doctors alike.

Continued Development

We are passionate about co-management because it is at the heart of TLC's growth strategy and it is the key to our outstanding clinical results. We know our long-term success depends on our ability to expand the cooperative relations we've already established between ophthalmology and optometry—both professions working together to provide the highest level of care to patients. We will continue to emphasize co-management—because it works.





Strategy for
Growth

2

The Financial Post
Dec. 3, 1997

**BeaconEye
rejects offer
for correction
centers**

The Financial Post
Dec. 31, 1997

**BeaconEye,
TLC talk again**

The Globe and Mail
Jan. 1, 1998

**BeaconEye
nears deal
with TLC**

The Financial Post
Feb. 27, 1998

**The trick of
valuing
BeaconEye**

The Financial Post
Feb. 26, 1998

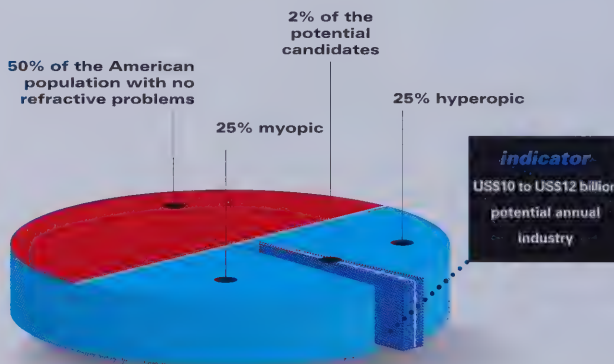
**TLC finally
wins
BeaconEye**

WHEREVER POSSIBLE, TLC STRIVES TO GAIN SUBSTANT

Increasing TLC's Market Penetration

By expanding TLC's portfolio of centers, we are positioning ourselves to take greater advantage of the rapidly growing market for laser vision correction.

The size of the potential market is tremendous. So big, in fact, it's sometimes difficult to put it in perspective.



Some 140 million Americans (50% of the population) are potential candidates for laser vision correction. If just 2% of the potential candidates choose to have the procedure each year, that translates into a US\$10 to US\$12 billion annual industry. To put that in some perspective, contact lenses have achieved market penetration somewhere in the neighborhood of 30%.

TLC is already in the best position to take advantage of this huge potential market and we hope to add between 10 and 15 new centers in fiscal 1999. TLC is accustomed to developing new laser centers at a very quick pace. We also happen to be the industry's most successful consolidator.

The Company plans to further expand its core laser vision correction business in three ways:

1. By building new centers
2. By buying existing centers
3. By acquiring other companies that have multiple locations

The TLC development process is disciplined and methodical.

TLC does not grow for growth's sake. We also try to avoid taking unnecessary risks. Our decision to pursue an expansion opportunity is guided by rigorous financial and operating criteria. We simply won't go ahead—we won't build or buy—unless the following conditions are met....

Four Rules We Live By

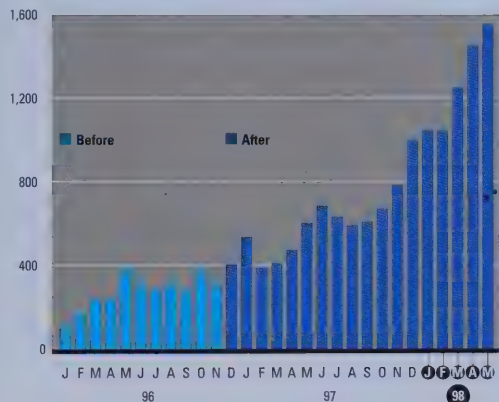
- The center must be supported by a core group of local co-managing doctors (traditionally more than 50)
- There must be one or two highly skilled surgeons who are well trained in laser vision correction techniques, are supported by the local doctor network and share TLC's commitment to the co-management model
- The target community must meet or exceed various demographic criteria
- We must be convinced that the center will provide TLC with a healthy return on our investment

TLC successfully completed the takeover of BeaconEye Inc. (one of our largest competitors) in April 1998. It's still early to predict how quickly we can make the BeaconEye operations profitable.

However, past experience suggests it might not take too long. Last year we acquired eight clinics from 20/20 Laser Centers.

Here's how we've managed them so far....

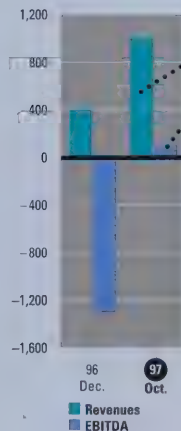
20/20 CENTER PROCEDURE VOLUMES
by month



indicator
300% increase
in procedure
volume

Procedure volume growth at the acquired 20/20 centers reflects both the market's expansion and TLC's success in building new co-management networks to support the clinics.

20/20 REVENUES AND EBITDA
US\$ thousands



indicator
150% increase
in revenues
+ US\$1.4 million positive
swing in EBITDA after
just 10 months

TLC has established a strong track record by successfully integrating and managing the acquisition of the 20/20 centers. The Company is now widely recognized as the most successful consolidator in its industry.



Strategy for
Growth

3

TLC TAKES A BROAD BASED APPROACH TO TOTAL EYE CARE

Building TLC's Secondary Care

Presence

TLC's network currently includes 17 secondary care centers and we hope to acquire a few more. Secondary care centers are important to our uniquely inclusive vision for the total eye care market.



Secondary care centers offer TLC an existing network of doctors, a solid revenue stream and a cost-effective way of opening a laser vision correction center.

It's important to understand that TLC is not a secondary care company, nor do we plan to become one. Our primary focus is on laser vision correction—TLC's core business which generates almost 90% of our revenues. That's why we only buy secondary care centers in communities where there is already a TLC laser center in existence or development.

What is a secondary care center?

A secondary care center is equipped for doctors to provide advanced levels of eye care (which can include surgery). Secondary care doctors treat eye problems such as glaucoma, cataracts, and retinal disorders.

What does TLC do for secondary care centers?

We build the business of the secondary care center by systematically applying our successful co-management model. TLC's strong network of co-managing doctors grows the referral base of the center. We also provide:

- sophisticated information systems and professional management
- group purchasing capabilities
- strong infrastructure
- financial ability to grow and gain market share

What does owning secondary care centers do for TLC?

1. It helps grow the number of vision correction procedures performed at our laser centers
2. It enlarges and strengthens the existing TLC network of referring doctors in the communities where we have laser centers
3. It secures long-term relationships with highly skilled surgeons who are often the same doctors that perform the procedures in our laser centers
4. It builds partnerships with world renowned doctors, helping enhance our clinical expertise, and establishes us as a clinical leader in our industry

Supporting TLC's Core Refractive Business

TLC operates a number of ancillary businesses and programs that help support our co-management model and, thereby, grow our dominant market position in the laser vision correction industry.

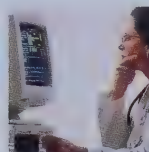
Managed Care

Of all laser vision correction companies, TLC is in a solid position to obtain managed care contracts with HMOs, insurance companies, employer groups and other third party payors. We have the economies of scale, the geographic diversification, and the large established network of doctors to make us the natural choice to partner with. After a year of building the necessary infrastructure and information systems, our managed care subsidiary—Partner Provider Health (PPH)—is aggressively moving into a sales mode. It has already signed its first contracts and generated its first revenues.

Information Technology

TLC's growing network of centers and co-managing doctors are being connected and supported by state-of-the-art information technology systems.

- The Eye Care Network is our on-line communications and group purchasing system that links our affiliated doctors with the Company, each other, and suppliers.
- TLC's sophisticated practice management software facilitates superior patient care and patient outcome analysis.
- TLC's web site at www.lvr.com furnishes a directory of eye care providers for potential patients, information about laser vision correction, and co-management information for local doctors.



The Vision Source

TLC subsidiary, The Vision Source Inc., is administered by practicing optometrists and provides marketing, management, and buying power to independently owned and operated optometric franchises in the U.S. TLC is committed to making independent eye care practices both competitive and successful. What's good for our local co-managing doctors can't help but benefit TLC.



Strategy for
Growth

4



A Member of
the TLC Group

The **Vision Source**



Growth Takes Leadership

Elias Vamvakas,

PRESIDENT AND CHIEF EXECUTIVE OFFICER
A co-founder of TLC in 1993, Mr. Vamvakas has an extensive background in management and finance. He is former President of the Creative Planning Financial Group of Companies.

Dr. Jeffery Machat,

NATIONAL MEDICAL DIRECTOR
Dr. Machat, co-founder of TLC, has performed more than 15,000 excimer laser procedures. He regularly lectures on excimer laser therapy and recently published his second book on the subject.

Frances Brotherhood,

EXECUTIVE VICE PRESIDENT,
SECONDARY CARE
Ms. Brotherhood was formerly Executive Vice President and Chief Operating Officer of BeaconEye Institute; Vice President, Excimer Laser Business; and President, Alcon Laboratories Inc.

Dr. David Eldridge,

EXECUTIVE VICE PRESIDENT,
CLINICAL AFFAIRS
Dr. Eldridge is Chairman of the TLC Advisory Council and has served as President of the American Academy of Optometry and President of the Oklahoma Optometric Association.

Gary Jonas,

EXECUTIVE VICE PRESIDENT,
STRATEGIC GROWTH
A Harvard MBA, Mr. Jonas is the founder and former President of 20/20 Laser Centers and the former President of Earl Palmer Brown, a national advertising agency in the U.S.

Peter Kastelic,

CHIEF FINANCIAL OFFICER AND TREASURER
Mr. Kastelic has served in key financial roles for a number of major companies including Potash Company of Canada as Vice President of Finance, and Vice President and Controller of Curragh Inc.

Ronald Kelly,

VICE PRESIDENT, ACQUISITIONS AND
GENERAL COUNSEL
Mr. Kelly is a former adjunct professor in contract law at the University of Western Ontario. He practices corporate/commercial and intellectual property law, including computer software development and high technology.

Henry Lynn

EXECUTIVE VICE PRESIDENT,
INFORMATION SYSTEMS
Mr. Lynn was formerly Vice President, Information Systems of BeaconEye Inc. and Vice President, Information Systems of Indal Ltd.

Dr. Stephen Slade,

NATIONAL MEDICAL DIRECTOR
Dr. Slade is on the clinical faculty of the University of Texas Medical School, Department of Ophthalmology. The co-author of several textbooks, he regularly travels internationally to teach and train surgeons in PRK and LASIK.

Madeline (Maddie) Walker,

CHIEF OPERATING OFFICER
Ms. Walker has held several key positions at TLC since the Company's founding. She is also President of Mainstay Human Resources Corporation, a management consulting company.



Management's **Discussion and Analysis** of Financial Condition and Results of Operations

Overview

TLC The Laser Center Inc., which began operations in September 1993, owns and manages eye care centers throughout North America and, together with its network of eye care providers, specializes in laser vision correction to correct common vision disorders such as myopia (nearsightedness), hyperopia (farsightedness) and astigmatism. Laser vision correction is an outpatient procedure, which is designed to change the curvature of the cornea to reduce or eliminate a patient's reliance on eyeglasses or contact lenses. To date, the Company has established or acquired 45 refractive centers and 17 secondary care centers in the United States and Canada which includes the recent acquisition of 11 BeaconEye centers in April 1998 (the Company acquired 97% of the outstanding shares of BeaconEye in April 1998, and completed its acquisition of the remaining shares of BeaconEye in May 1998). Including the six weeks of BeaconEye center operations, the Company performed over 35,800 procedures during the fiscal year 1998, making TLC the world's largest provider of laser vision correction services.

The Company recognizes revenues at the time services are rendered. Net revenues include only those revenues pertaining to owned laser centers and management fees from managing

refractive and secondary care practices. Under the terms of the practice management agreements, the Company provides management, marketing and administrative services to refractive and secondary care practices in return for management fees. Management services revenue in some cases is equal to the net revenue of the physician practice, less amounts retained by the physician groups, and in some cases is based upon a fixed management/facility fee arrangement. The principal components of operating expenses are wages and facility leasing costs.

The Company continues to pursue a growth strategy in its core refractive laser surgery business, which accounts for more than 86% of net revenues. It is expected that in addition to "same store" growth, several new centers will be built or acquired during fiscal year 1999 to increase procedure volume and position the Company for continuing growth. The Company's continued growth and future profitability are affected by the extent to which laser vision correction becomes more widely accepted in North American markets and other factors. The Company anticipates that the percentage of revenue derived from the core refractive business will continue to increase as the market for laser vision correction grows.

Results of Operations

(U.S. dollars in thousands)

1998	Refractive	Secondary Care	Other	1998 Total
Net revenues	US\$ 51,079	US\$ 6,641	US\$ 1,402	US\$ 59,122
Doctor compensation	5,242	—	—	5,242
Net revenue after doctor compensation	45,837	6,641	1,402	53,880
Operating expenses	41,620	6,294	1,607	49,521
Interest and other	416	87	189	692
Depreciation and amortization	7,107	2,185	168	9,460
Non-recurring charge	—	(1,555)	—	(1,555)
Income (loss) from operations before non-recurring charge	US\$ (3,306)	US\$ (370)	US\$ (562)	US\$ (4,238)
1997	Refractive	Secondary Care	Other	1997 Total
Net revenues	US\$ 15,130	US\$ 4,982	US\$ —	US\$ 20,112
Doctor compensation	1,476	—	—	1,476
Net revenue after doctor compensation	13,654	4,982	—	18,636
Operating expenses	15,637	3,961	—	19,598
Interest and other	637	115	—	752
Depreciation and amortization	2,728	735	—	3,463
Income (loss) from operations	US\$ (5,348)	US\$ 171	US\$ —	US\$ (5,177)

Net revenues for the fiscal 1998 year increased US\$39.0 million to US\$59.1 million, which is an increase of 194% over last year's US\$20.1 million total. More than 86% of total net revenues were derived from refractive surgery as compared to 75% in fiscal 1997 demonstrating the increasing significance of the Company's core business.

Net revenues from refractive centers for fiscal 1998 increased US\$36.0 million to US\$51.1 million, which is an increase of 238% over last year's US\$15.1 million total. More than 35,800 paid procedures were performed in fiscal 1998 compared to 11,000 procedures in fiscal 1997. The increasing revenues reflect strong growth in the number of procedures performed at existing sites, the development of new centers and the recent acquisition of the BeaconEye

centers which accounted for 1,300 paid procedures in fiscal 1998.

Net revenues from secondary care centers increased US\$1.6 million to US\$6.6 million from US\$5.0 million in fiscal 1997, an increase of 33%. Higher revenues from TLC Northwest Eye Inc. and the acquisition of TLC Michigan in February 1998 accounted for the majority of the revenue growth.

Operating expenses and doctor compensation increased US\$33.7 million to US\$54.8 million in fiscal 1998 from US\$21.1 million in fiscal 1997, an increase of 160%. This increase is a result of: (i) increased variable expenses associated with the increase in the number of laser vision correction procedures performed at existing refractive centers and (ii) increased fixed and variable costs from the addition of new refractive centers.

Operating expenses and doctor compensation as a percentage of net revenues were 93% for fiscal 1998 as compared to 105% in fiscal 1997. This decrease is attributed to the higher percentage of refractive centers that had been open for more than one year and were recording higher revenues.

Interest expense and other of US\$0.7 million was unchanged, which includes higher interest expenses on long-term debt and capital leases that was offset by higher interest income and foreign exchange gains.

Depreciation and amortization expense increased to US\$9.5 million in fiscal 1998 from US\$3.5 million in fiscal 1997. This is a result of a full year's depreciation expense on 23 centers which were built during fiscal 1997. In addition amortization of goodwill increased to US\$1.7 million in fiscal 1998 from US\$0.5 million in fiscal 1997 resulting primarily from the full year amortization of the 20/20 acquisition goodwill. Goodwill is amortized on a straight line basis over fifteen years.

Start-up and development expenses represent non-recurring costs incurred to research and develop potential businesses in North America, including salaries and benefits, professional fees, advertising, promotion and travel expenses, and costs incurred by the businesses during the period prior to commencement of commercial operations. These costs decreased 23% to US\$3.3 million as compared to US\$4.3 million in fiscal 1997. During fiscal 1998, the majority of start-up and development costs were incurred by Partner Provider Health ("PPH") for the development of the managed care business. PPH has been established with the goal of strengthening the doctor network and supporting affiliated doctors, in conjunction with the Company's co-management strategy.

Income tax expense increased to US\$1.1 million in fiscal 1998 from

US\$0.1 million in fiscal 1997. This increase is a result of certain Canadian center profits being taxed in Canada as U.S. losses cannot be applied to offset such Canadian taxable income.

The net loss for fiscal 1998 was US\$9.5 million or US\$0.34 per share, compared to a loss of US\$9.6 million or US\$0.47 cents a share the previous year. The similar loss is a result of a US\$2.0 million smaller operating loss from refractive being entirely offset by US\$2.1 million poorer operating performance from secondary care operations. Secondary care operating losses are a result of new costs associated with new secondary care centers that have not yet established their revenue stream. The secondary care operating loss included a total of US\$1.5 million of non-recurring asset write-downs and other charges at the Chicago and Seattle secondary care clinics. The most significant component of the US\$1.5 million charge arose from a contractual dispute with the doctor group affiliated with the Company's Chicago center. The loss from refractive operations includes US\$0.9 million in losses from BeaconEye, which was acquired six weeks before the fiscal year end.

Year Ended May 31, 1997 Compared to Year Ended May 31, 1996

Net revenues from refractive centers increased to US\$15.1 million for fiscal 1997 from US\$5.5 million for fiscal 1996 which represents an increase of 175% over fiscal 1996's total. This increase is attributed to the growth in the number of laser vision correction procedures performed at refractive centers, which increased to 11,026 from 3,685 the previous year.

Net revenues from secondary care centers increased by 400%, from US\$1.0 million for fiscal 1996 to US\$5.0 million for fiscal 1997. A full year's accounting of revenues, and an

increase in revenues, from the TLC Northwest Eye Inc. secondary care centers (Washington State) and the acquisition of the TLC Midwest Eye secondary care centers (Illinois) contributed to the growth in net revenues.

Operating expenses and doctor compensation increased from US\$5.6 million for fiscal 1996 to US\$21.1 million for fiscal 1997. This increase is attributed to: (i) increased variable expenses associated with the increase in the number of laser vision correction procedures performed at existing centers; and (ii) increased fixed and variable costs from the addition of new refractive centers.

Interest and other expenses were unchanged at US\$0.7 million for fiscal 1996 and fiscal 1997. While interest expense increased in fiscal 1997 to US\$0.9 million as compared to US\$0.2 million in fiscal 1996, which is attributed to the higher level of debt outstanding, this higher cost was offset by foreign exchange gains and interest income.

Depreciation and amortization expense increased from US\$0.6 million for fiscal 1996 to US\$3.5 million for fiscal 1997. This increase is attributed to the addition of assets principally resulting from the addition of 22 refractive centers in fiscal 1997, as well as the inclusion of US\$0.5 million of goodwill amortization attributed to the acquisition of 20/20 in February 1997.

Start-up and development expenses increased from US\$1.6 million for fiscal 1996 to US\$4.3 million for fiscal 1997. Start-up and development expenses for fiscal 1997 include US\$1.1 million in costs attributable to PPH. These costs were incurred to set up a new claims processing center and to develop other infrastructure.

The net loss for fiscal 1996 was US\$2.0 million or US\$0.16 per share,

compared to US\$9.6 million or US\$0.47 per share for fiscal 1997.

Liquidity and Capital Resources

The Company has financed its operations to date through cash flow, the issuance of Common Shares, borrowings and capital lease financing.

On April 22, 1998, the Company completed a public offering in the United States and Canada of 4,740,000 Common Shares at US\$14.50 per share (the "Offering"). Net proceeds to the Company, after deducting underwriting discounts and commissions, were approximately US\$64.6 million. The proceeds of this offering are being used to finance further expansion plans including the acquisition and development of additional refractive centers. The Company estimates that the net proceeds of the Offering, together with existing cash balances, funds expected to be generated from operations and available credit facilities, will be sufficient to fund the Company's anticipated level of operations and its current acquisition and expansion plans for the next 18 months.

Working capital increased from US\$8.1 million at May 31, 1997 to US\$54.1 million at May 31, 1998, primarily due to the public offering completed on April 22, 1998.

At May 31, 1998, unrestricted cash and marketable securities totaled US\$56.1 million, an increase of US\$42.9 million from the US\$13.2 million balance on May 31, 1997 due to the public offering.

Net cash utilized by operating activities for the year ended May 31, 1998 amounted to \$11.8 million, as compared to US\$6.9 million for the year ended May 31, 1997. The increase in cash

usage is due largely to higher accounts receivable because of more insurance cases both in secondary care and refractive operations. The Company continued to invest in assets to develop and expand its refractive procedure capacity in anticipation of continued growth. The Company also acquired BeaconEye Inc. for US\$16.3 million, which resulted in the addition of 11 clinics.

Recent Developments

In April 1998 the Company, through a take-over bid circular, acquired 97% of the common shares of BeaconEye Inc. The share acquisition was financed through the issue of 842,980 Common Shares. On May 27, 1998, the Company completed the acquisition of the remaining shares of BeaconEye Inc., with an issuance of an additional 29,312 Common Shares. TLC has combined operations and staff of the two companies. This combination required: (i) the closure of BeaconEye corporate offices in Fort Worth Texas and Mississauga Ontario, (ii) staff layoffs, (iii) the implementation of the TLC co-management model at BeaconEye centers, and (iv) the integration of information systems.

On June 8, 1998 the Company made a portfolio investment of US\$8 million in cash through the purchase of 2,000,000 preference shares in LaserSight which are convertible to common shares at US\$4.00 per share. This investment was made in part to fund the start-up and development of mobile laser business in North America.

Year 2000 Compliance

The Company is aware of the issues associated with the programming code

in existing computer systems as the year 2000 approaches. The "year 2000 problem" is pervasive and complex. Systems that do not properly recognize such information could generate erroneous data or cause a system to fail. The Company is reviewing internal systems and is communicating with outside customers and vendors to determine where systems may fail. Although there can be no assurance, the Company does not believe that it will incur significant operating expenses or be required to invest heavily in computer systems improvements to be year 2000 compliant. Any year 2000 compliance problem encountered by the Company, its suppliers or its customers could have a material adverse impact on the Company's business, financial condition and results of operations.

New Accounting Pronouncements

The Emerging Issues Task Force has issued EITF Abstract No. 97-2, "Application of FASB Statement No. 94, Consolidation of All Majority-Owned Subsidiaries, and APB Opinion No. 16, Business Combinations, to Physician Practice Management Entities and Certain Other Entities with Contractual Management Arrangements," which is effective for the Company's May 31, 1999 year end. This abstract addresses, amongst other things, the circumstances under which it is appropriate to consolidate physician practices managed by the Company. The Company expects that it will continue to not consolidate physician practices under its management.

This Annual Report contains certain forward-looking statements within the meaning of Section 27A of the U.S. Securities and Exchange Act of 1934 and Section 21E of the Securities Exchange Act of 1934, which statements can be identified by the use of forward-looking terminology, such as "may," "will," "expect," "anticipate," "estimate," "predict," "plans" or "continue" or the negative thereof or other variations thereon or comparable terminology referring to future events or results. The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of numerous factors, including the timing of acquisitions and expansion opportunities, any of which could cause actual results to vary materially from current results or TLC's anticipated future results. See the Company's reports filed with the Toronto Stock Exchange and the U.S. Securities and Exchange Commission from time to time for cautionary statements identifying important factors with respect to such forward-looking statements, including certain risks and uncertainties, that could cause actual results to differ materially from results referred to in forward-looking statements. TLC assumes no obligation to update the information contained in this annual report.

Responsibility for Financial Statements

The accompanying consolidated financial statements of **TLC The Laser Center Inc.** have been prepared by management in accordance with accounting principles generally accepted in Canada consistently applied. The most significant of these accounting policies have been set out in note 1 to the financial statements. These statements are presented on the accrual basis of accounting. Accordingly, a precise determination of many assets and liabilities is dependent upon future events. Therefore, estimates and approximations have been made using careful judgement. Recognizing that the Company is responsible for both the integrity and objectivity of the financial statements, management is satisfied that these financial statements have been prepared within reasonable limits of materiality.

The Board of Directors has appointed an Audit Committee consisting of three outside directors. The committee meets during the year to review with management and the auditors any significant accounting, internal control and auditing matters and to review and finalize the annual financial statements of the Company along with the independent auditors' report prior to the submission of the financial statements to the Board of Directors for final approval.

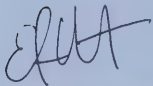
The financial information throughout the text of this annual report is consistent with the information presented in the financial statements.

The Company's accounting procedures and related systems of internal control are designed to provide reasonable assurance that its assets are safeguarded and its financial records are reliable.

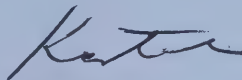
External Auditors

The auditors' opinion is based upon an independent and objective examination of the Company's financial results for the year, conducted in accordance with generally accepted auditing standards. This examination encompasses an understanding and evaluation by the auditors of the Company's accounting systems as well as the obtaining of a sound understanding of the Company's business. The external auditors conduct appropriate tests of the Company's transactions and obtain sufficient audit evidence in order to provide them with reasonable assurance that the financial statements are presented fairly in accordance with generally accepted accounting principles, thus enabling them to issue their report to the shareholders.

Ernst & Young, Chartered Accountants, having been appointed by the shareholders to serve as the Company's external auditors, have examined the consolidated financial statements of the Company for the year ended May 31, 1998, and have reported thereon in their July 15, 1998 report.



Elias Vamvakas
PRESIDENT AND
CHIEF EXECUTIVE OFFICER



Peter Kastelic
CHIEF FINANCIAL OFFICER
AND TREASURER

Auditors' **Report**

To the Shareholders of TLC The Laser Center Inc.

We have audited the consolidated balance sheet of TLC The Laser Center Inc. as at May 31, 1998 and the consolidated statements of income, deficit and changes in financial position for the year ended May 31, 1998. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at May 31, 1998 and the results of its operations and the changes in its financial position for the year ended May 31, 1998 in accordance with accounting principles generally accepted in Canada.

The financial statements as at May 31, 1997 and for each of the years in the two year period ended May 31, 1997, prior to the change in reporting currency described in note 1, were audited by other auditors who expressed an opinion without reservation on those statements in their report dated August 8, 1997. We have examined the restatement of such financial statements for the change in reporting currency and, in our opinion, such restatement is appropriate and has been properly applied.

The logo for Ernst + Young, featuring the company name in a stylized, handwritten-style script.

Chartered Accountants

TORONTO, CANADA
JULY 15, 1998

Consolidated Statement of Income



Years ended May 31

(U.S. dollars, in thousands except per share amounts)

	1998	1997	1996
Net revenues			
Refractive	\$ 51,079	\$ 15,130	\$ 5,474
Secondary care	6,641	4,982	952
Other	1,402	—	—
Net revenues (note 13)	59,122	20,112	6,426
Expenses			
Doctor compensation			
Refractive	5,242	1,476	953
Operating	49,521	19,598	4,609
Interest and other (note 10)	692	752	675
Depreciation and amortization (note 10)	9,460	3,463	601
	64,915	25,289	6,838
LOSS FROM OPERATIONS BEFORE START-UP AND DEVELOPMENT EXPENSES	(5,793)	(5,177)	(412)
Start-up and development expenses	3,267	4,292	1,584
LOSS BEFORE INCOME TAXES AND NON-CONTROLLING INTEREST	(9,060)	(9,469)	(1,996)
Income taxes			
Current (note 11)	1,071	95	72
Deferred	—	10	(89)
	1,071	105	(17)
LOSS BEFORE NON-CONTROLLING INTEREST	(10,131)	(9,574)	(1,979)
Non-controlling interest	593	—	—
NET LOSS FOR THE YEAR	\$ (9,538)	\$ (9,574)	\$ (1,979)
LOSS PER SHARE	\$ (0.34)	\$ (0.47)	\$ (0.16)
Weighted average number of Common Shares outstanding	28,034,741	20,617,104	12,796,579

Consolidated Statement of Deficit

Years ended May 31

(U.S. dollars, in thousands)

	1998	1997	1996
Balance, beginning of year	\$ (12,141)	\$ (2,567)	\$ (588)
Net loss for the year	(9,538)	(9,574)	(1,979)
Balance, end of year	\$ (21,679)	\$ (12,141)	\$ (2,567)

Consolidated Balance Sheets



As at May 31

(U.S. dollars, in thousands)

1998

1997

Assets

Current assets

Cash and short-term deposits (note 2)	\$ 1,895	\$ 13,230
Marketable securities (note 14)	54,234	—
Accounts receivable (note 14)	10,282	2,784
Income taxes recoverable	—	32
Prepays and sundry assets	4,632	1,590

Total current assets	71,043	17,636
Restricted cash (note 2)	2,086	1,167
Intangibles and other assets (note 3)	48,852	31,120
Capital assets (note 4)	31,049	16,813
Assets under capital lease (note 5)	11,182	7,010

Total assets	\$ 164,212	\$ 73,746
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Liabilities

Current liabilities

Accounts payable and accrued liabilities	\$ 9,096	\$ 6,677
Current portion of long-term debt	2,861	1,242
Current portion of obligations under capital lease	3,951	1,631
Current portion of term bank loan	—	27
Income taxes payable	613	—
Deferred compensation (note 8)	320	—
Deferred income taxes	118	4

Total current liabilities	16,959	9,581
Long-term debt (note 6)	8,378	4,548
Obligations under capital lease (note 7)	9,533	6,371
Term bank loan	—	16
Deferred rent and compensation (note 8)	1,110	1,531

Total liabilities	35,980	22,047
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Non-controlling interest	6,357	318
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Commitments (note 12)

Shareholders' Equity

Capital stock (note 9)	143,554	63,522
Deficit	(21,679)	(12,141)

Total shareholders' equity	121,875	51,381
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Total liabilities and shareholders' equity	\$ 164,212	\$ 73,746
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Approved on behalf of the Board:

Elias Vamvakas

DIRECTOR

Howard J. Gourwitz

DIRECTOR

Consolidated Statements of Changes in Financial Position



Years ended May 31

(U.S. dollars, in thousands)

	1998	1997	1996
Operating activities			
Net loss for the year	\$ (9,538)	\$ (9,574)	\$ (1,979)
Items not affecting cash			
Depreciation and amortization	9,460	3,463	601
Depreciation and amortization included in start-up and development expenses	—	—	106
Non-controlling interest	(593)	—	—
Deferred income taxes (net)	—	10	(89)
Other	22	313	167
Changes in non-cash operating items			
Accounts receivable	(6,964)	56	(1,126)
Prepays and sundry assets	(2,129)	(1,226)	(290)
Accounts payable and accrued liabilities	(2,480)	(500)	1,331
Income taxes payable (net)	647	(105)	43
Deferred rent and compensation	(234)	698	60
Cash provided by (used for) operating activities	(11,809)	(6,865)	(1,176)
Financing activities			
Restricted cash	463	(961)	(206)
Long-term debt	1,313	2,751	2,384
Term bank loan	(43)	(27)	(27)
Obligations under capital lease	1,490	4,771	392
Non-controlling interest	412	98	—
Capital stock issued	80,032	50,028	12,492
Cash provided by (used for) financing activities	83,667	56,660	15,035
Investing activities			
Capital assets	(4,460)	(12,782)	(10,520)
Assets under capital lease	(2,196)	(4,480)	(391)
Acquisitions	(21,561)	(21,717)	—
Marketable securities	(54,234)	—	—
Other	(742)	(224)	(707)
Cash provided by (used for) investing activities	(83,193)	(39,203)	(11,618)
Increase (decrease) in cash	(11,335)	10,592	2,241
Cash and short-term deposits, beginning of year	13,230	2,638	397
Cash and short-term deposits, end of year	\$ 1,895	\$ 13,230	\$ 2,638

Notes to the Consolidated Financial Statements

(All amounts in U.S. dollars except where noted otherwise and all tabular amounts in thousands)

Nature of Operations

TLC The Laser Center Inc. and its subsidiaries (the “Company”) develop and manage laser vision correction centers in the United States and Canada. Each center provides excimer laser and other clinical equipment and all related management and support services to physicians and physician practices performing excimer laser procedures in the Company’s centers.

The Company also owns and manages secondary eye care centers in the United States. These centers provide all necessary clinical equipment and infrastructure and provide all related management and support services to physician practices treating a wide range of vision disorders.

The Company faces a number of risks and uncertainties given the nature of the industry in which it operates.

The Company’s profitability is dependent upon broad acceptance in the United States and Canada of laser vision correction as an alternative to existing methods of treating refractive disorders. Broad market acceptance is dependent on many factors including cost, the lack of long-term follow up data and the resulting concerns relating to safety and effectiveness, and future regulatory developments.

The industry in which the Company operates is subject to extensive federal, state and local laws, rules and regulations. Many of these laws and regulations are ambiguous in nature and have not been definitively interpreted by courts and regulatory authorities. Moreover, they vary from jurisdiction to jurisdiction. Accordingly, the Company may not always be able to predict clearly how such laws and regulations will be interpreted or applied and some of the Company’s activities could be challenged. In addition, there can be no assurance that the regulatory environment in which the Company operates will not change significantly in the future.

Most states in the United States prohibit the Company from practicing medicine or employing physicians to practice medicine on the Company’s behalf. Because the Company does not practice medicine, its activities are limited to owning and managing refractive centers and secondary care centers and affiliating with health care providers to render medical services at the Company’s centers. As a result, the Company is highly dependent on its affiliated doctors.

The provision of medical services entails an inherent risk of potential malpractice and other similar claims. Although the Company does not engage in the practice of medicine, there can be no assurance that claims relating to services provided at the Company’s centers will not be asserted against the Company. The Company currently maintains malpractice insurance that it believes to be adequate both as to risks and

amounts. In addition, the doctors providing medical services at the Company’s centers are required to maintain insurance.

The Company’s revenues from managing secondary care centers are derived from fees paid by or on behalf of patients to the practices affiliated with the Company. The Company’s profitability could be affected by government and private third-party payors seeking to contain healthcare costs by reducing reimbursement rates, lowering utilization rates and negotiating reduced payment schedules with providers of vision care.

1. Accounting Policies

These consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in Canada, conform in all material respects with accounting principles generally accepted in the United States, except as explained in note 17.

Basis of Presentation

These consolidated financial statements include the accounts of the Company and its majority owned subsidiaries, partnerships and other entities in which the Company has more than a 50% ownership interest and exercises control. The ownership interests of other parties in less than wholly owned consolidated subsidiaries, partnerships and other entities are presented as non-controlling interests. All significant intercompany transactions and balances have been eliminated in consolidation.

The Company does not have an ownership interest in, nor does it exercise control over, the physician practices under its management. Accordingly, the Company does not consolidate physician practices under its management.

Reporting Currency

Historically, the Company’s consolidated financial statements have been expressed in Canadian dollars. As a result of increased business activity in the United States (“U.S.”) resulting principally from recent U.S. acquisitions, the opening of new centers in the U.S. and the Company’s growing U.S. shareholder base, the U.S. dollar has become the unit of measure of the large majority of the Company’s operations. Accordingly, the U.S. dollar has been adopted as the Company’s reporting currency effective May 31, 1998. The consolidated financial statements and the notes thereto have been restated in U.S. dollars for all periods presented, in accordance with Canadian generally accepted accounting principles, using the May 31, 1998 exchange rate of CDN\$1.4570 per US\$1.00.

1. Accounting Policies (cont'd)

For periods up to May 31, 1998, the U.S. dollar denominated assets and liabilities of the Company's Canadian operations and its integrated U.S. operations were translated into Canadian dollars at exchange rates prevailing at the balance sheet date for monetary items and at exchange rates prevailing at the transaction dates for non-monetary items. U.S. dollar denominated income and expenses were translated into Canadian dollars at average exchange rates prevailing during the year with the exception of depreciation and amortization, which was translated at historical exchange rates. Exchange gains and losses were included in earnings, except for unrealized gains and losses on translation of U.S. dollar denominated debt which were deferred and amortized over the remaining term of the related obligation. The Canadian dollar consolidated financial statement amounts so derived have been restated in U.S. dollars using the May 31, 1998 exchange rate described above.

For periods after May 31, 1998, the unit of measure of the parent holding company will be the U.S. dollar. In addition, the Company's Canadian operations are considered integrated and will be translated into U.S. dollars using the temporal method. Accordingly, the assets and liabilities of the Company's Canadian operations will be translated into U.S. dollars at exchange rates prevailing at the balance sheet date for monetary items and at exchange rates prevailing at the transaction dates for non-monetary items. Income and expenses will be translated into U.S. dollars at average exchange rates prevailing during the year with the exception of depreciation and amortization, which will be translated at historical exchange rates. Exchange gains and losses will be included in earnings, except for unrealized gains and losses on translation of Canadian dollar denominated debt which will be deferred and amortized over the remaining term of the related obligation.

Capital Assets and Assets Under Capital Lease

Capital assets and assets under capital lease are carried at cost less accumulated depreciation and amortization. Depreciation and amortization is provided at rates intended to write off the assets over their productive lives as follows:

Computer equipment and software	- straight line over three years
Furniture, fixtures and equipment	- 20% diminishing balance
Laser equipment	- 20% diminishing balance
Leasehold improvements	- straight line over the initial term of the lease
Medical equipment	- 20% diminishing balance
Vehicles	- 30% diminishing balance

For assets acquired or brought into use during the year, depreciation and amortization is calculated at half the normal rate.

Intangible Assets and Other

The practice management agreements represent the cost of obtaining the exclusive right to manage secondary care centers in affiliation with the related physician group during the term of the agreements. Practice management agreements are amortized using the straight line method over fifteen years.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired, and is being amortized on a straight line basis over 15 years. On an ongoing basis, management reviews the valuation and amortization of goodwill, taking into consideration any events and circumstances which might have impaired the carrying value. Goodwill is written down to net recoverable value when declines in value are considered to be other than temporary based upon expected undiscounted cash flows of the related acquired business.

Start-up and Development Expenses

Start-up and development expenses represent costs incurred to research and develop potential businesses in North America, including salaries and benefits, professional fees, advertising, promotion and travel, and costs incurred by businesses during the period prior to commencement of commercial operations. Start-up and development expenses are expensed as incurred.

Revenues

The Company includes in income only those operating revenues pertaining to owned laser centers and management fees earned from managing refractive and secondary care practices. Under the terms of the practice management agreements, the Company provides management, marketing and administrative services to refractive and secondary care practices in return for management fees.

Management service revenue is equal to the net revenue of the physician practice, less amounts retained by the physician groups. Net revenue of the physician practice is recorded by the physician groups at established rates reduced by provision for doubtful accounts, contractual adjustments and amounts retained by physician groups. Contractual adjustments arise due to the terms of certain

reimbursement and managed care contracts. Such adjustments represent the difference between the charges at established rates and estimated recoverable amounts and are recognized in the period the services are rendered. Any differences between estimated contractual adjustments and actual final settlements under reimbursement contracts are recognized as contractual adjustments in the year final settlements are determined.

Deferred Income Taxes

The Company follows the tax allocation method of providing for income taxes. Under this method, deferred income taxes result from the recording of certain income or expenses for accounting purposes in periods other than those in which they are reported for income tax purposes.

Cash and Short-term Deposits

Cash and short-term deposits include short-term investments with original maturities of up to 90 days.

Marketable Securities

Marketable securities, which consist principally of corporate bonds, are carried at the lower of cost and market.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. These estimates are reviewed periodically, and, as adjustments become necessary, they are reported in earnings in the period in which they become known.

2. Cash

	1998	1997
Cash and short-term deposits	\$ 1,895	\$ 2,935
Funds held in escrow on issuance of special warrants (note 9)	—	10,295
	\$ 1,895	\$ 13,230

The Company has a banking facility of approximately CDN\$1,700,000 available for posting letters of guarantee, under terms whereby the Company must maintain a similar minimum amount in its bank account. US\$692,000 of this facility has been utilized at May 31, 1998 (US\$1,167,000 at May 31, 1997). In addition, the Company has posted cash collateral deposits in respect of certain lease commitments, such deposits amount to US\$1,394,000 at May 31, 1998 (nil at May 31, 1997). These restricted cash amounts have been excluded from cash and short-term deposits.

3. Intangibles and Other Assets

	1998	1997
Goodwill (net of amortization of US\$2,164,000 (1997 – US\$470,000))	\$ 32,401	\$ 23,611
Practice management agreements (net of amortization of US\$2,174,000 (1997 – \$511,000))	14,788	6,527
Other	1,663	982
	\$ 48,852	\$ 31,120

Notes to the Consolidated Financial Statements (cont'd)

(All amounts in U.S. dollars except where noted otherwise and all tabular amounts in thousands)

4. Capital Assets

	1998		1997	
	Cost	Accumulated Depreciation	Cost	Accumulated Depreciation
Computer equipment and software	\$ 6,356	\$ 2,766	\$ 725	\$ 128
Deposit on lasers	—	—	2,782	—
Furniture, fixtures and equipment	5,678	1,628	2,534	555
Laser equipment	8,640	2,837	4,596	796
Leasehold Improvements	14,911	3,380	4,769	652
Medical equipment	7,762	1,943	3,579	453
Vehicles and other	311	55	428	16
	43,658	12,609	19,413	2,600
Less: accumulated depreciation	12,609		2,600	
Net book value	\$ 31,049		\$ 16,813	

5. Assets Under Capital Lease

	1998	1997
Computer equipment	\$ 177	\$ 25
Furniture, fixtures and equipment	393	142
Laser equipment	12,082	7,146
Medical equipment	2,325	623
	14,977	7,936
Accumulated depreciation	3,795	926
	\$ 11,182	\$ 7,010

6. Long-term Debt

	1998	1997
Participating loans		
Interest at 18%, due December 1999 to February 2001, collateralized by equipment	\$ 3,903	\$ 4,618
Term bank loans		
Interest from LIBOR plus 2.25% to 8.50%, due December 2000 to February 2003, collateralized by equipment	7,336	1,172
	11,239	5,790
Less current portion	2,861	1,242
	\$ 8,378	\$ 4,548

The participating loan agreements provided for additional monthly payments on principal based on a percentage of net revenues in excess of the minimum monthly payments. Such additional monthly payments ceased once the lender received a specified implicit rate of return. During fiscal 1998, the participating loan terms were amended to increase the minimum monthly payments to a level based on the original specified implicit rate of return and to eliminate the additional monthly payments based on a percentage of revenue.

The majority of long-term debt is denominated in U.S. currency.

Aggregate minimum repayments of principal for each of the next five years are as follows:

1999	\$ 2,861
2000	\$ 2,918
2001	\$ 2,920
2002	\$ 1,952
2003	\$ 588

7. Obligations Under Capital Leases

The leases expire between 1999 and 2003 and include imputed interest at rates ranging from 5% to 16%. The majority of capital leases are denominated in U.S. currency. The capitalized lease obligations represent the present value of future minimum annual lease payments as follows:

	1998	1997
1998	\$ —	\$ 2,510
1999	5,946	2,574
2000	5,821	2,395
2001	5,009	1,757
2002	4,002	1,170
2003	809	262
	21,587	10,668
Less interest portion	(8,103)	(2,666)
	13,484	8,002
Less current portion	3,951	1,631
	\$ 9,533	\$ 6,371

8. Deferred Rent and Compensation

Deferred rent represents the benefit of operating lease inducements which benefits are being amortized on a straight line basis over the related lease terms. Deferred compensation represents a plan to compensate certain key managerial executives and was included as part of the acquisition of 20/20 Laser Centers, Inc. ("20/20") (note 15). The plan vests 100% on the earlier of February 15, 1999 or termination of employment, as defined. US\$320,000 (May 31, 1997 – US\$577,000) is accrued on potential deferred compensation of US\$320,000 (May 31, 1997 – US\$809,000).

9. Capital Stock

	1998	1997
Common—authorized, unlimited number of shares		
- issued: 33,667,843 (1997 – 25,189,707) shares	\$ 143,554	\$ 53,858
- special warrants	—	9,664
	\$ 143,554	\$ 63,522

Since May 31, 1995, the following additional shares and options were issued:

	Common Shares		Special Warrants	
	# of Shares	\$ Value	# of warrants	\$ Value
May 31, 1995	10,917	1,002	—	—
Private offering, net of issue costs	502	861		
Shares issued as part of Employee Stock Plan	479	—		
Initial Public Offering ("IPO"), net of issue costs	3,200	7,414		
Shares issued to acquire TLC Northwest Eye	1,389	3,918		
Exercise of agent's compensation warrants related to the IPO	31	97		
Shares issued as over-allotment options to an agent of the IPO	71	202	—	—

9. Capital Stock (cont'd)

	Common Shares		Special Warrants	
	# of Shares	\$ Value	# of warrants	\$ Value
May 31, 1996	16,589	13,494	—	—
Exercise of agent's compensation warrants related to the IPO	158	486		
Public offering, net of issue costs	4,025	18,015		
Shares issued to acquire 20/20	4,364	21,717		
Exercise of stock options	43	86		
Issuance of special warrants, net of issue costs			1,818	9,664
Other	10	60		
May 31, 1997	25,189	53,858	1,818	9,664
Conversion of special warrants	1,818	9,664	(1,818)	(9,664)
Additional special warrant issue costs		(40)		
Shares issued for acquisitions (1) (note 15)	1,604	16,417		
Exercise of agent's compensation warrants related to the IPO	138	447		
Exercise of stock options	179	786		
Public offering, net of issue costs	4,740	62,422		
May 31, 1998	33,668	143,554	—	—

(1) This includes approximately 421,804 shares issued in connection with the acquisition of The Vision Source, Inc. The Common Shares issued are held in escrow. Release of approximately 210,902 of these shares is subject to an earn out formula. These shares represent contingent purchase consideration and, therefore, they will not be valued until completion of the earn out period and the outcome of the contingency is known. The remaining approximately 210,902 shares will be released from escrow within 15 months from the issue date (see note 15).

At May 31, 1998, the Company has reserved 4,116,000 Common Shares for issuance under its stock option plan. Options granted have terms ranging from 5 to 8 years. Vesting provisions on options granted to date include options that vested immediately, options that vest in equal amounts annually over the first four years of the option term and options that vest entirely on the first anniversary from the grant date. Exercise prices, which are denominated in Canadian dollars, for options outstanding as of May 31, 1998 range from CDN\$2.50 to CDN\$17.90 (US\$1.72 to US\$12.29).

	Options	Weighted Average Strike Price Per Share	Weighted Average Strike Price Per Share
May 31, 1995	20	CDN\$1.50	US\$1.03
Granted	2,225	3.39	2.33
Exercised	(479)	4.11	2.82
May 31, 1996	1,766	CDN\$3.19	US\$2.19
Granted	320	7.25	4.98
Exercised	(20)	1.50	1.03
	(23)	4.11	2.82
Forfeited	(74)	6.65	4.56
May 31, 1997	1,969	CDN\$3.73	US\$2.56
Granted	518	11.79	8.09
Exercised	(71)	6.12	4.20
May 31, 1998	2,416	CDN\$5.39	US\$3.70
Exercisable at May 31, 1998	1,954	CDN\$3.91	US\$2.68

The Company also has the following stock options outstanding at May 31, 1998:

- options for various officers of 20/20 with outstanding options to acquire 20/20 shares. The Company has agreed that, immediately upon exercise of the 20/20 options, the Company will issue Common Shares in exchange for the 20/20 shares acquired on exercise, on the basis of 0.37517 Common Shares for every 20/20 share as follows:
- 60,869 (May 31, 1997 – 167,746) Common Shares at US\$4.44 per TLC Common Share
- 6,296 Common Shares at US\$5.33 per TLC Common Share
- 7,503 Common Shares at US\$8.00 per TLC Common Share all expiring on March 1, 1999.

During fiscal 1998, 20/20 options were exercised and the resulting 20/20 shares issued were exchanged for 106,877 Common Shares at US\$4.44 per share.

- 20/20 options were granted to third parties for services rendered to 20/20 at US\$0.01 per share expiring March 1, 1999. The Company will issue Common Shares exchange for the 20/20 shares acquired on exercise, on the basis of 0.37517 Common Shares for every 20/20 share for a total of 202,592 Common Shares.

10. Interest and Other and Depreciation and Amortization Expenses

	1998	1997	1996
Interest and other			
Interest on long-term debt	\$ 1,200	\$ 655	\$ 74
Interest on capital leases	1,177	266	61
Interest and bank charges, net	(351)	(5)	82
Foreign exchange losses (gains)	(1,334)	(164)	458
	<u>\$ 692</u>	<u>\$ 752</u>	<u>\$ 675</u>
Depreciation and amortization			
Capital assets	\$ 4,394	\$ 1,925	\$ 426
Assets under capital lease	1,709	598	134
Goodwill	1,694	470	—
Practice management agreements	1,663	470	41
	<u>\$ 9,460</u>	<u>\$ 3,463</u>	<u>\$ 601</u>

11. Income Tax Losses

As at May 31, 1998, the Company and its subsidiaries have non-capital losses carried forward for income tax purposes of approximately US\$64,957,000, including fiscal 1998 losses of approximately US\$4,677,000, which are available to reduce taxable income of future years.

The Canadian losses can only be utilized by the source company whereas the United States losses are utilized on a United States consolidated basis. The Canadian losses of US\$10,059,000 expire between 2001 and 2005. The United States losses of US\$54,898,000 expire between 2008 and 2013. Included in the Canadian losses are US\$8,920,000 of losses and in the United States losses are US\$44,955,000 of losses from the acquisitions of 20/20 and BeaconEye, of which the availability and timing of utilization may be restricted. The differences between the provision for income taxes and the amount computed by applying the statutory Canadian income tax rate to loss before income taxes and non-controlling interest were as follows:

	1998
Income tax recovery based on the	
Canadian statutory income tax rate of 43%	\$ (3,896)
Current year losses not benefited	2,196
Non-deductible start-up costs net of amortization	479
Non-deductible depreciation and amortization	1,484
Non-deductible allowances	376
Cash vs. accrual tax deductions	1,545
Utilization of prior year losses	(1,225)
State income taxes	131
Large corporation tax	69
Other	(88)
Income tax provision	<u>\$ 1,071</u>

The income tax provision is as follows:

	1998
Current	
Canada	\$ 940
United States – federal	—
United States – state	131
	<u>\$ 1,071</u>

Notes to the Consolidated Financial Statements (cont'd)

(All amounts in U.S. dollars except where noted otherwise and all tabular amounts in thousands)

12. Commitments

At May 31, 1998, the Company has entered into operating leases for rental office space and equipment, which require future minimum lease payments aggregating US\$22,810,000. Future minimum lease payments over the next five years are as follows:

1999	\$ 5,509
2000	\$ 4,915
2001	\$ 4,617
2002	\$ 4,172
2003	\$ 3,597

One of the Company's subsidiaries together with other investors have jointly and severally guaranteed the obligations of an equity investee. Total liabilities of the equity investee under guarantee amount to approximately US\$2,900,000 at May 31, 1998.

13. Segmented Information

The Company's business segments are as follows:

1998	Refractive	Secondary Care	Other	1998 Total
Revenues and physician costs				
Gross revenues of all owned and managed clinics	\$ 65,297	\$ 23,869	\$ 1,413	\$ 90,579
Amounts retained by doctor group	(10,566)	(4,711)	(11)	(15,288)
Contractual allowances and adjustments	(3,652)	(12,517)	—	(16,169)
Net revenues	51,079	6,641	1,402	59,122
Doctor compensation	5,242	—	—	5,242
Net revenue after doctor compensation	\$ 45,837	\$ 6,641	\$ 1,402	\$ 53,880
Expenses				
Operating	41,620	6,294	1,607	49,521
Interest and other	416	87	189	692
Depreciation and amortization	7,107	2,185	168	9,460
	49,143	8,566	1,964	59,673
Income (loss) from operations	\$ (3,306)	\$ (1,925)	\$ (562)	\$ (5,793)
Total assets	\$ 137,746	\$ 23,887	\$ 2,599	\$ 164,232

1997	Refractive	Secondary Care	Other	1997 Total
Revenues and physician costs				
Gross revenues of all owned and managed clinics	\$ 18,548	\$ 14,294	\$ —	\$ 32,842
Amounts retained by doctor group	(1,452)	(6,251)	—	(7,703)
Contractual allowances and adjustments	(1,966)	(3,061)	—	(5,027)
Net revenues	15,130	4,982	—	20,112
Doctor compensation	1,476	—	—	1,476
Net revenue after doctor compensation	\$ 13,654	\$ 4,982	\$ —	\$ 18,636
Expenses				
Operating	15,637	3,961	—	19,598
Interest and other	637	115	—	752
Depreciation and amortization	2,728	735	—	3,463
	19,002	4,811	—	23,813
Income (loss) from operations	\$ (5,348)	\$ 171	\$ —	\$ (5,177)
Total assets	\$ 65,108	\$ 8,676	\$ —	\$ 73,784
1996	Refractive	Secondary Care	Other	1996 Total
Revenues and physician costs				
Gross revenues of all owned and managed clinics	\$ 5,474	\$ 5,512	\$ —	\$ 10,986
Amounts retained by doctor group	—	(2,307)	—	(2,307)
Contractual allowances and adjustments	—	(2,253)	—	(2,253)
Net revenues	5,474	952	—	6,426
Doctor compensation	953	—	—	953
Net revenue after doctor compensation	\$ 4,521	\$ 952	\$ —	\$ 5,473
Expenses				
Operating	4,082	527	—	4,609
Interest and other	653	22	—	675
Depreciation and amortization	480	121	—	601
	5,215	670	—	5,885
Income (loss) from operations	\$ (694)	\$ 282	\$ —	\$ (412)
Total assets	\$ 7,723	\$ 9,096	\$ —	\$ 16,819

Notes to the Consolidated Financial Statements (cont'd)

(All amounts in U.S. dollars except where noted otherwise and all tabular amounts in thousands)

13. Segmented Information (cont'd)

The Company's geographic segments are as follows:

1998	Canada	United States	1998 Total
Revenues and physician costs			
Gross revenues of all owned and managed clinics	\$ 12,527	\$ 78,052	\$ 90,579
Amounts retained by doctor group	(653)	(14,635)	(15,288)
Contractual allowances and adjustments	(699)	(15,470)	(16,169)
Net revenues	11,175	47,947	59,122
Doctor compensation	1,475	3,767	5,242
Net revenue after doctor compensation	\$ 9,700	\$ 44,180	\$ 53,880
Expenses			
Operating	11,206	38,315	49,521
Interest and other	(1,646)	2,338	692
Depreciation and amortization	1,321	8,139	9,460
	10,881	48,792	59,673
Income (loss) from operations	\$ (1,181)	\$ (4,612)	\$ (5,793)
Total assets	\$ 87,948	\$ 76,284	\$ 164,232
Capital expenditures	\$ 717	\$ 5,939	\$ 6,656
1997	Canada	United States	1997 Total
Revenues and physician costs			
Gross revenues of all owned and managed clinics	\$ 7,745	\$ 25,097	\$ 32,842
Amounts retained by doctor group	—	(7,703)	(7,703)
Contractual allowances and adjustments	—	(5,027)	(5,027)
Net revenues	7,745	12,367	20,112
Doctor compensation	895	581	1,476
Net revenue after doctor compensation	\$ 6,850	\$ 11,786	\$ 18,636
Expenses			
Operating	9,350	10,248	19,598
Interest and other	(213)	965	752
Depreciation and amortization	480	2,983	3,463
	9,617	14,196	23,813
Income (loss) from operations	\$ (2,767)	\$ (2,410)	\$ (5,177)
Total assets	\$ 16,272	\$ 57,510	\$ 73,784
Capital expenditures	\$ 846	\$ 16,416	\$ 17,262

1996	Canada	United States	1996 Total
Revenues and physician costs			
Gross revenues of all owned and managed clinics	\$ 5,002	\$ 5,984	\$ 10,986
Amounts retained by doctor group	—	(2,307)	(2,307)
Contractual allowances and adjustments	—	(2,253)	(2,253)
Net revenues	5,002	1,424	6,426
Doctor compensation	953	—	953
Net revenue after doctor compensation	\$ 4,049	\$ 1,424	\$ 5,473
Expenses			
Operating	2,943	1,666	4,609
Interest and other	609	66	675
Depreciation and amortization	367	234	601
	3,919	1,966	5,885
Income (loss) from operations	\$ 130	\$ (542)	\$ (412)
Total assets	\$ 4,696	\$ 12,123	\$ 16,819
Capital expenditures	\$ 758	\$ 10,153	\$ 10,911

14. Financial Instruments

Fair Value

The carrying amounts of cash and short-term deposits, accounts receivable, income taxes recoverable, accounts payable and accrued liabilities and income taxes payable approximates their fair values because of the short-term maturities of these items.

Given the large number of individual long-term debt instruments and capital lease obligations held by the Company, it is not practicable within constraints of timeliness and cost to determine fair value. However, the Company expects that if it were able to renegotiate such instruments at the current market rates available to the Company, it would obtain more favorable terms given the Company's growth and current financial position.

The fair values of the Company's marketable securities are based on quotes from brokers.

The Company's marketable securities portfolio consists substantially of long-term corporate bonds. The bonds were purchased with the proceeds from the Company's April 1998 share offering and at May 31, 1998 the bonds had remaining

terms to maturity not exceeding six months with a substantial majority of the bonds having terms to maturity of less than one month. It is the Company's intention to hold the bonds to their maturity.

	1998	1997
Fair values		
Marketable securities	\$ 54,641	\$ —

Risk Management

The Company is exposed to credit risk on accounts receivable from its customers. In order to reduce its credit risk, the Company has adopted credit policies, which include the analysis of the financial position of its customers and the regular review of credit limits. The Company does not have a significant exposure to any individual customer, except for amounts due from those refractive and secondary eye practices which it manages and which are collateralized by the practice's patient receivables. As at May 31, 1998, there was one individual amount in excess of 10% of total accounts receivable which amounted to US\$3,099,000. The accounts

Notes to the Consolidated Financial Statements (cont'd)

(All amounts in U.S. dollars except where noted otherwise and all tabular amounts in thousands)

14. Financial Instruments (cont'd)

receivable from nine other practices under management aggregated to US\$3,435,000 at May 31, 1998, which represents 34% of total accounts receivable.

Cash accounts at the Canadian banks are insured by Canadian Depositary Insurance Corporation for up to US\$60,000. In the United States, the Federal Depositary Insurance Corporation insures cash balances up to US\$100,000. At May 31, 1998, bank deposits exceeded insured limits by US\$3,475,275.

The Company operates internationally and is therefore exposed to market risks related to foreign currency fluctuations. As well, there is cash flow exposure to interest rate fluctuations on debt carrying floating rates of interest.

15. Acquisitions

BeaconEye Inc.

On April 16, 1998, the Company, through a take-over bid circular, acquired 97% of the common shares of BeaconEye Inc. ("BeaconEye") and the remaining 3% was acquired by April 24, 1998. The acquisition was financed through the issuance of 872,293 Common Shares.

The Company's investment in BeaconEye has been accounted for by the purchase method and the results of operations have been consolidated from May 27, 1998.

The total cost of the acquisition was allocated to the net assets acquired on the basis of their fair values as follows:

Current assets	\$ 1,200
Restricted cash	1,380
Capital assets and assets under capital lease	15,844
Goodwill	9,011
Current liabilities assumed	(6,141)
Long-term debt and obligations under capital lease	(5,037)
	<u>\$ 16,257</u>
Funded by	
Issuance of Common Shares	\$ 11,692
Funding of BeaconEye obligations and restructuring costs through April 16, 1998	4,483
Acquisition costs	82
	<u>\$ 16,257</u>

Wisconsin

In the fourth quarter of 1998, the Company formed a new wholly owned subsidiary in the State of Wisconsin (the "subsidiary"). The subsidiary entered into a practice management agreement with a local doctor group, and intends to jointly develop a medical practice to be owned by the local doctor group and managed by the subsidiary. In consideration for entering into the practice management agreement, the Company issued the consideration described below which was allocated to the net assets acquired as follows:

Practice management agreement	\$ 2,881
Funded by	
Issuance of Common Shares	\$ 2,581
Cash	300
	<u>\$ 2,881</u>

Michigan

On February 1, 1998, the Company entered into an agreement (the "Venture") in the State of Michigan. The Venture, called TLC Michigan, L.L.C., is owned 50.1% by the Company and 49.9% by a group of ophthalmologists. The Venture owns secondary care centers throughout Michigan, and, through subsidiaries, a refractive laser center and an 80% interest in a cosmetic laser center in the Detroit area.

The Company's investment in the Venture has been accounted for by the purchase method and the results of operations have been consolidated from February 1, 1998.

The total cost of the acquisition was allocated to the net assets acquired on the basis of their fair values as follows:

Current assets (including cash of US\$500,000)	\$ 552
Capital assets	567
Practice management agreement	6,403
Investment in subsidiaries	754
Note receivable	4,682
Other assets	146
Current liabilities including	
current portion of long-term debt	(298)
Long-term debt	(332)
Minority interest	(5,912)
	\$ 6,562
Funded by	
Issuance of Common Shares	\$ 626
Contribution of cash	500
Contribution of assets	754
Note payable to the Venture	4,682
	\$ 6,562

The Vision Source, Inc.

On July 23, 1997, the Company acquired 100% of the common shares of The Vision Source, Inc. The acquisition was financed through the issuance of 421,804 Common Shares (see note 9). The purchase price of US\$1,303,000 was allocated primarily to goodwill. The Common Shares issued are held in escrow. Release of 210,902 of these shares is subject to an earn out formula. These shares represent contingent purchase consideration and, therefore, will not be valued until completion of the earn out period and the outcome of the contingency is known. The remaining 210,902 shares will be released from escrow within 15 months from the issue date.

20/20 Laser Centers, Inc.

On February 10, 1997, the Company acquired 99.9% of the common shares of 20/20. The acquisition was financed through the issuance of Common Shares (see note 9). The results of operations of 20/20 have been consolidated from the date of acquisition.

The total cost of the acquisition, using the purchase method of accounting, was allocated to the net assets acquired on the basis of their book values and then adjusted for fair values as follows:

Book values	
Current assets	\$ 1,663
Capital assets	1,954
Assets under capital lease	3,555
Other assets	268
Current liabilities	(5,443)
Obligations under capital lease	(2,380)
Other liabilities	(604)
Non-controlling interest	(220)
	(1,207)
Fair value adjustments	
Assets under capital lease	(1,146)
Goodwill	24,070
	\$ 21,717

16. Comparative Figures

Certain comparative figures have been reclassified to conform with the current year's presentation.

17. Difference Between Canadian and United States Generally Accepted Accounting Principles

These consolidated financial statements are prepared in accordance with accounting principles generally accepted ("GAAP") in Canada. The most significant differences between Canadian and United States GAAP, insofar as they affect the Company's consolidated financial statements, are described below.

The following table reconciles results as reported under Canadian GAAP with those that would have been reported under U.S. GAAP:

	1998	1997	1996
Net loss for the year—			
Canadian GAAP	\$ (9,538)	\$ (9,574)	\$ (1,979)
Deferred foreign exchange losses (i)	(742)	—	—
Differences in accounting for stock-based compensation (APB 25) (ii)	—	—	(1,350)
Net loss for the year—			
U.S. GAAP	\$ (10,280)	\$ (9,574)	\$ (3,329)
Loss per share—U.S. GAAP (iii)	\$ (0.37)	\$ (0.47)	\$ (0.26)

(i) The gain or loss on translation of foreign currency denominated long-term monetary items is deferred and amortized over the remaining life of the item under Canadian GAAP. Under U.S. GAAP, the gain or loss on translation is included in income when it arises.

(ii) The APB25 adjustment affects the U.S. GAAP balance sheet resulting in an increase in capital stock and an increase in deficit.

(iii) SFAS No. 128, "Earnings Per Share," is effective for fiscal periods ending after December 15, 1997. This statement has been retroactively applied to all periods presented and it had no significant effect on the reported U.S. GAAP earnings per share data for the years ended May 31, 1998, 1997, and 1996.

Shareholders' equity under U.S. GAAP would have been US\$121,133,000 at May 31, 1998 (US\$51,381,000 at May 31, 1997).

Additional disclosures required related to the reconciliation of the consolidated financial statements from Canadian to U.S. GAAP are as follows:

(a) Statement of Changes in Financial Position

The Company's fiscal 1996 acquisition of TLC Northwest Eye Inc., financed in part through the issuance of Common

Shares, would be considered a non-cash transaction under U.S. GAAP resulting in a reduction in cash provided by financing activities of US\$3,918,000 and a reduction in cash used in investing activities of US\$3,918,000.

The Company's fiscal 1997 acquisition of 20/20, financed through the issuance of Common Shares, would be considered a non-cash transaction under U.S. GAAP resulting in a reduction in cash provided by financing activities of US\$21,717,000 and a reduction in cash used in investing activities of US\$21,717,000.

The portion of the purchase prices financed through the issuance of Common Shares for the Company's fiscal 1998 acquisitions of The Vision Source, Inc., the Michigan Venture, the Wisconsin Venture and BeaconEye would be considered non-cash transactions under U.S. GAAP resulting in a reduction in cash provided by financing activities of US\$16,417,000 and a reduction in cash used in investing activities of US\$16,417,000.

The Company has acquired capital assets financed through capital lease obligations which would be considered non-cash transactions under U.S. GAAP resulting in a reduction in cash provided by financing activities and a corresponding reduction in cash used in investing activities of the following amounts:

Year ended May 31, 1998	\$ 2,196
Year ended May 31, 1997	4,480
Year ended May 31, 1996	391

Interest paid in cash is not substantially different than interest expense in all periods presented.

Income taxes paid in cash were US\$458,000 in fiscal 1998. Amounts paid in cash in prior years were not significant.

(b) Stock-based Compensation

SFAS No. 123, "Accounting for Stock-based Compensation," became effective for the Company's Fiscal 1997 year. The Company continues to account for its outstanding fixed price stock options under Accounting Principles Board Opinion 25, "Accounting for Stock Issued to Employees," which results in the recording of no compensation expense in the Company's circumstances. Had compensation expense for stock options granted been determined based upon fair value at the grant date consistent with the methodology described under SFAS No. 123, the pro forma effects of fiscal 1996, 1997 and 1998 grants on the net loss and loss per share amounts for the years ended May 31, 1998, 1997 and 1996 would have been as follows:

	1998	1997	1996
Net loss under U.S. GAAP	\$ (10,280)	\$ (9,574)	\$ (3,329)
Adjustments for SFAS 123	(1,195)	(662)	(875)
Pro forma net loss under U.S. GAAP	\$ (11,475)	\$ (10,236)	\$ (4,204)
Pro forma loss per share under U.S. GAAP	\$ (0.41)	\$ (0.49)	\$ (0.33)

The fair value of the options granted was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions: risk free interest rate of 5%; dividend yield of 0%, volatility of the expected market price of the Company's Common Shares of 0.60; and a weighted average expected option life of 2.5 years. The Black-Scholes option valuation model was developed for use in estimating fair value of traded options which have no vesting restrictions and are fully transferable. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the above pro forma adjustments for SFAS 123 are not necessarily a reliable single measure of the fair value of the Company's employee stock options.

(c) Income Taxes

Deferred income taxes under U.S. GAAP consist of the following temporary differences:

	1998
Assets:	
Tax benefit of loss carry forwards	
Pre-acquisition	\$ 22,132
Post-acquisition	4,446
Start-up costs	1,180
Valuation allowance	(27,758)
	\$ —
Liabilities:	
Practice management agreements (1)	\$ 7,728
Other	118
	\$ 7,846

(1) Under U.S GAAP, deferred taxes are recorded based on the difference between the values assigned for accounting purposes and the tax values of individual assets acquired in business combinations, except for nondeductible goodwill. The only such significant differences with respect to the Company are the practice management agreement assets acquired through the TLC Northwest Eye Inc. acquisition in fiscal 1996, and the Michigan Venture and Wisconsin venture acquisitions in fiscal 1998. Under U.S. GAAP, this deferred tax liability is matched by an equal increase in the value assigned to the practice management agreement assets. In the statement of income, the resulting increased annual asset amortization is offset by an equal deferred tax recovery with no effect on the net loss.

(d) Pro Forma Effects of Acquisitions

Under APB 16, the Company is required to disclose the following information relating to its acquisitions:

If 20/20 had been acquired on June 1, 1995, the pro forma effects on the statements of income for the fiscal periods ended May 31, 1996 and 1997 would have been additional net revenues of US\$2,164,000 and US\$3,288,000 and additional net losses of US\$5,616,000 and US\$5,344,000, respectively, based on unaudited 20/20 financial statements for those periods.

If BeaconEye had been acquired on June 1, 1996, the unaudited pro forma effects on the statements of income for the fiscal periods ended May 31, 1997 and 1998 would have been additional net revenues of US\$7,229,000 and US\$5,979,000 and additional net losses of US\$16,995,000 and US\$16,143,000, respectively.

(e) Reporting Currency

Effective May 31, 1998, the Company adopted the U.S. dollar as its reporting currency. Prior to this change the Canadian dollar had been used as the Company's reporting currency. Under Canadian GAAP, the Company's financial statements for all periods presented through May 31, 1998 have been translated from Canadian dollars to U.S. dollars using the exchange rate in effect at May 31, 1998. Under U.S. GAAP, the financial statements for periods prior to the change in reporting currency must be translated to U.S. dollars using the current rate method, which method uses specific year end or specific annual average exchange rates as appropriate. The application of the current rate method to the periods presented did not result in any material differences from the Canadian GAAP financial statements, and as such, these differences are not presented in this note.

17. Difference Between Canadian and United States Generally Accepted Accounting Principles (cont'd)

(f) Other

Under SEC Staff Accounting Bulletin 74, the Company is required to disclose certain information related to new accounting standards which have not yet been adopted due to delayed effective dates.

SFAS No. 130, "Comprehensive Income," and SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," are effective for the Company's May 31, 1999 year end. The Company has not yet determined the impact of these pronouncements on its consolidated financial statements.

The Emerging Issues Task Force has issued EITF Abstract No. 97-2, "Application of FASB Statement No. 94, Consolidation of All Majority-Owned Subsidiaries, and APB Opinion No. 16, Business Combinations, to Physician Practice Management Arrangements," which is effective for the Company's May 31, 1999 year end. This abstract addresses, amongst other things, the circumstances under which it is appropriate to consolidate physician practices managed by the Company. The Company expects that it will continue to not consolidate physician practices under its management.

18. Uncertainty due to the Year 2000 Issue

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect the Company's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the Company, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

19. Subsequent Events

LaserSight Incorporated

On June 8, 1998, the Company made a portfolio investment of US\$8.0 million in cash through the purchase of 2,000,000 preference shares in LaserSight Incorporated. These preference shares are convertible to LaserSight Incorporated common shares at US\$4.00. This investment was made to fund the start-up and development of mobile open access excimer lasers to individual doctors and networks throughout North America. The companies will focus on providing the best technology in a cost-effective manner to both urban and rural based ophthalmic surgeons.

AllSight, Inc.

On June 16, 1998, the Company made a 51% equity investment of US\$204,000 in cash in AllSight, Inc., a refractive laser center in the Pittsburgh, PA area.

Western Oklahoma Eye Center

On June 16, 1998, the Company acquired the operating assets and liabilities of Western Oklahoma Eye Center in exchange for cash and common shares. Consideration for this acquisition was US\$182,000 and US\$835,000 respectively. Simultaneous with the acquisition, the Company entered into a long-term Practice management agreement with Dr. John Belardo, P.C.

TLC's Core Principles

Core Purpose

To enable people to enjoy life through advanced medical care and to promote the success of all of our partners.

Core Values

Integrity

Integrity builds respect and trust. We communicate openly and honestly with each other, and to all with whom we do business. We can be counted on to keep our promise and to use good judgement, and if we make a mistake we will accept responsibility and do everything possible to correct it. We will conduct business with impeccable ethics and a genuine desire to do the right thing. We are reliable, honest and trustworthy in all our dealings.

We Always Seek To Improve

In all aspects of our business we continually accept change as a positive, particularly when it's for the better. We study our progress and learn from ourselves and others how to do things more effectively and efficiently. How we do things is as important to us as what we do.

We Do What Is Right

We are committed to the highest standards of patient care and excellence in everything that we do on behalf of TLC's patients, affiliated doctors, employees, shareholders and suppliers. We are proud to work for a health care company whose products and services make a difference in people's lives and for an organization whose primary objective is to provide the highest level of patient care. We derive our greatest sense of accomplishment from doing what is right—not what is expedient.

We Accept Personal Responsibility

We consider individual involvement and accountability to be both a right and a privilege and accept personal responsibility for everything we do. We treat the Company's reputation as our own and try to make wise use of our time and the Company's resources. While we support our associates and work as a team, we will always take pride and accept personal responsibility in meeting or exceeding desired objectives.

Employee Ownership

TLC encourages its employees to think like owners through its employee share option plan.

The Company also introduced an employee share purchase plan this year.

As a group, senior management and directors hold a large portion of TLC's outstanding common shares.

Corporate Information

Directors

Elias Vamvakas (1993)

BSc (Honours), CHFC

President, Chief Executive Officer and
Chairman of the Board of Directors
TLC The Laser Center Inc.

Jeffery J. Machat (1993)

MD, FRCSC, DABO

Co-National Medical Director
TLC The Laser Center Inc.

Howard J. Gourwitz (1995) 1, 2, 3

JD, LLM

Attorney and Counselor-at-Law, Shareholder
Gourwitz and Barr, P.C.

W. David Sullins Jr., (1995) 1, 2, 3

RADM, OD, DOS, FAAO

President and Chief of Clinical Services
Athens Eye Care Clinic, P.C.

John F. Riegert (1995)

CMC, CMA, CDP

Secretary TLC The Laser Center Inc.

James R. Connacher (1996) 1, 3

Vice-Chairman

Gordon Capital Corporation

Warren S. Rustand (1997) 2, 3

Chairman and Chief Executive Officer
Rural/Metro Corporation

(199x) Year appointed director

¹ Member Compensation Committee

² Member Audit Committee

³ Member Corporate Governance Committee

The Board of Directors of TLC believes that strong corporate governance practices are essential to the well being of the Corporation and its shareholders. A description of TLC's corporate governance policies is available from the Company at no charge. Requests should be directed to Stephen Kilmer, Manager, Investor Relations at the Company's corporate office.

Officers and Executives

Elias Vamvakas

President and Chief Executive Officer

Dr. Jeffery Machat

Co-National Medical Director

Frances Brotherhood

Executive Vice President, Secondary Care

Dr. David Eldridge

Executive Vice President, Clinical Affairs

Gary Jonas

Executive Vice President, Strategic Growth

Peter J. Kastelic

Chief Financial Officer and Treasurer

Ronald Kelly

Vice President, Acquisitions and
General Counsel

Henry Lynn

Executive Vice President, Information Systems

John Riegert

Secretary

Madeline (Maddie) Walker

Chief Operating Officer

Corporate Office

TLC The Laser Center Inc.
5600 Explorer Drive,
Suite 301,
Mississauga, Ontario
L4W 4Y2
Tel: (905) 602-2020
Fax: (905) 602-2025

Legal Counsel

Canada

Tory Tory Deslauriers & Binnington
Toronto, Ontario

U.S.

Arent Fox Kinter Plotkin & Kahn, PLLC
Washington, D.C.

Independent Auditors

Ernst & Young

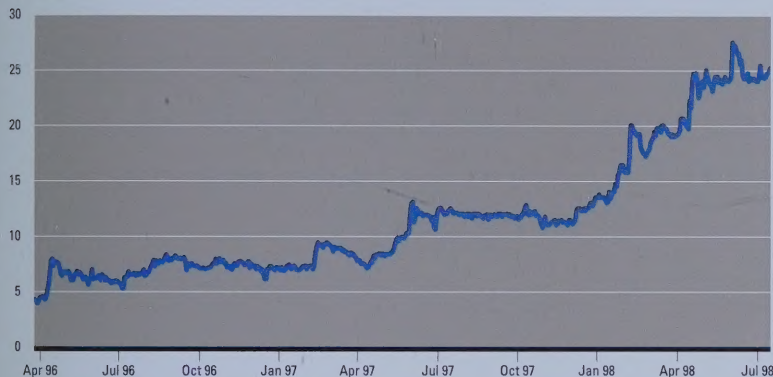
Toronto, Ontario

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on glasses or contacts,
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free screening.

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www.lzr.com

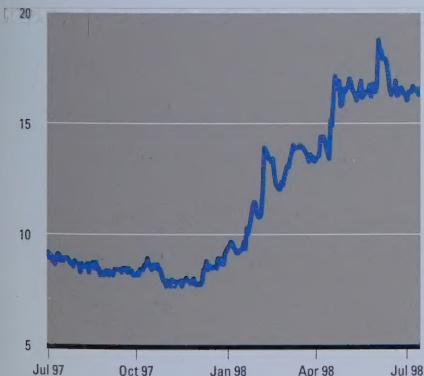
Shareholder Information

LZR ON THE TSE
CDN\$



	1997					1998			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter		1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
High	\$ 8.30	\$ 8.20	\$ 9.40	\$ 12.00	High	\$ 13.05	\$ 12.80	\$ 20.00	\$ 25.00
Low	\$ 5.25	\$ 6.90	\$ 6.10	\$ 7.10	Low	\$ 10.60	\$ 10.75	\$ 11.10	\$ 17.90
Close	\$ 8.00	\$ 7.25	\$ 9.10	\$ 12.00	Close	\$ 11.90	\$ 11.45	\$ 17.70	\$ 24.00

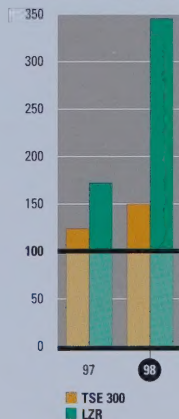
LZRCF ON NASDAQ
US\$



	1998			
	1st Quarter*	2nd Quarter	3rd Quarter	4th Quarter
High	\$ 9.25	\$ 9.00	\$ 14.00	\$ 17.234
Low	\$ 8.25	\$ 7.75	\$ 7.813	\$ 12.688
Close	\$ 8.25	\$ 7.938	\$ 12.313	\$ 16.50

* LZRCF began trading on the NASDAQ National Market on July 3, 1997.

**CUMULATIVE
TOTAL RETURN
ON \$100 INVESTMENT***
based on CDN\$100
invested on May 31, 1996



* Assumes reinvestment of dividends

Investor Relations

Shareholders, analysts, investment professionals, members of the media, and potential investors who would like information about TLC's activities should contact:

Stephen Kilmer

Tel: 1-800-TLC-1033 or

Tel: (905) 602-2020

Fax: (905) 602-2025

Email: investor.relations@lzc.com

TLC on the Internet

Interested investors may browse TLC's website at www.lzc.com to obtain regularly updated information including press releases, share trading data, quarterly reports and financial statements.

Transfer Agent and Shareholder Records

Shareholders requiring information or assistance regarding individual stock records or stock certificates should contact the Transfer Agent:

The CIBC Mellon Trust Company

Tel: 1-800-387-0825

Stock Exchange Listing

Shares of the Corporation are listed on The Toronto Stock Exchange and NASDAQ National Market.

Trading Symbols

TSE - LZR

NASDAQ - LZRCF

Reporting Calendar

The year end is May 31. The annual report is mailed in September, and quarterly reports are mailed in October, January, and April.

Form 10-K

A copy of the Company's Annual Report on Form 10-K (without exhibits) is available from the Company at no charge. Requests should be directed to Stephen Kilmer, Manager, Investor Relations at the Company's corporate office.

Annual Meeting

The Annual Meeting of Shareholders will be held at 10:00 a.m. on October 30, 1998 at the TSE Conference Center, 2 First Canadian Place, Toronto, Ontario.

See the Best. See TLC.

Have you ever wondered what life would be like without having to depend on glasses or contact lenses? Then you should consider laser vision correction. It has been performed over one million times with exciting results, and it can change the way you see things forever. Everyday, more and more people choose TLC The Laser Center to correct their vision. In fact, more now choose TLC than any other network.

Here's why:

- 👁️ TLC corrects nearsightedness, farsightedness, and astigmatism using proven laser technology to reduce or even eliminate our patients' dependence on glasses and contact lenses.
- 👁️ TLC stands behind its results for life with The TLC Lifetime Commitment.
- 👁️ TLC was the first company to offer this benefit to laser vision correction patients.
- 👁️ More than 7,000 optometrists and ophthalmologists are affiliated with TLC—chances are, your own eye doctor is too. The best doctors work with TLC.
- 👁️ TLC's doctors were the first in Canada and the U.S. to perform the LASIK procedure and were pioneers in its development.
- 👁️ TLC performs more laser vision correction procedures than any other network in North America. Many of our patients are referred from previous patients who are excited by their good results.
- 👁️ With 45 laser centers across Canada and the U.S., TLC is conveniently located for almost any patient.

To see if you're a laser vision correction candidate, call us today at **1-888-CALL-TLC**.



www.lzr.com